FARM CREDIT FOCUS

2008 ANNUAL REPORT
FARM CREDIT BANK OF TEXAS

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FARM CREDIT BANK OF TEXAS
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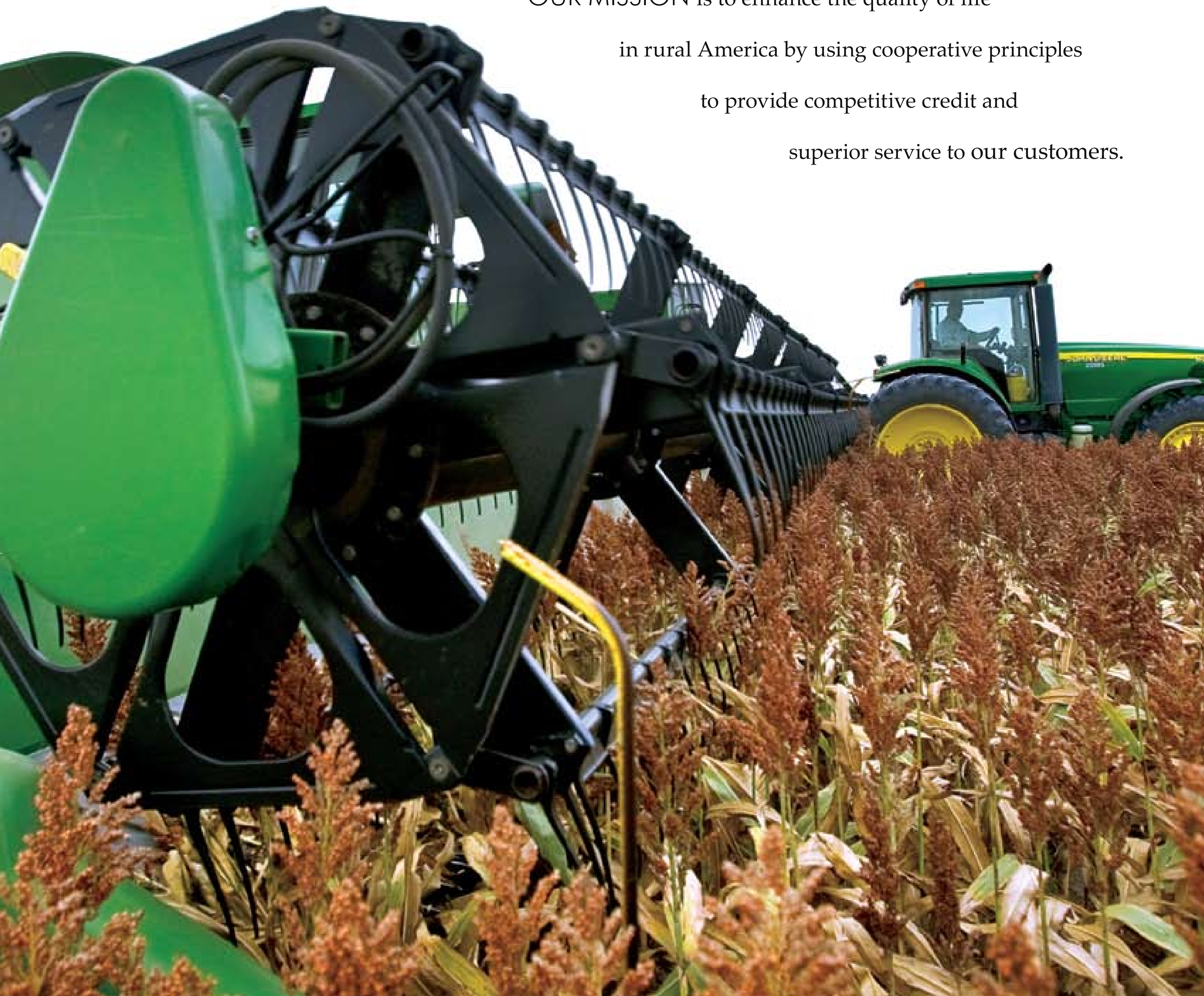
FarmCreditBank.com
FindFarmCredit.com

At Farm Credit Bank of Texas, our focus is on agriculture and rural America. Other lenders may come and go in the agricultural and rural financing business but our entire reason-for-being is to serve this sector of the economy by providing our customer-owners with competitive credit and superior service. As a result, we support the nation's food and fiber system and enhance the quality of life for all Americans.

During the turbulence that rocked the global financial sector in 2008, virtually every lender felt the tremors. A number of institutions were shaken, and a few collapsed. Farm Credit Bank of Texas, however, stood strong and stable, just as we have for the past 92 years. Farm Credit was established for times like these. By focusing on our mission and our strengths, we continue to provide access to credit for the people and businesses that make up rural America.

FARM CREDIT FOCUS

OUR MISSION is to enhance the quality of life in rural America by using cooperative principles to provide competitive credit and superior service to our customers.



BOARD OF DIRECTORS
FARM CREDIT BANK OF TEXAS

Jimmy Dodson

Jon "Mike" Garnett
Vice Chairman

Betty Flores

Ralph W. "Buddy" Cortese
Chairman

William Staats

OUR COOPERATIVE STRUCTURE: strong, transparent,

Joe Crawford

Kenneth Andrews

customer-focused

The cooperative structure has always been a source of our strength and the foundation of all our decisions.

Last year, our cooperative structure was put to the test as credit markets tightened and some lenders had difficulty accessing the capital markets. Instead of suspending our operations, the global financial crisis served to underscore the unique advantages provided by our cooperative structure and business model. In 2008, Farm Credit securities remained an attractive investment option, second only to U.S. Treasury notes. As a result, we were able to continue providing our customer-owners with funds and services they needed to meet their financing requirements.

Focusing on our cooperative business model offers other advantages as well. Because our customers are our owners, we return earnings to them when we are successful, effectively lowering their cost of funds. In return, when our retail lending co-ops do well, they pay patronage to their customer-stockholders too — farmers, ranchers, agribusiness firms, country homeowners and rural landowners, who make up the borrowing base of the Farm Credit System.

We are extremely proud that at a time when other lenders were offering less to their customers, we paid a record cash patronage to our customer-owners in 2008. Even more significant, all of our affiliated retail lending cooperatives declared patronage to their stockholders, thereby reducing their customers' effective cost of borrowing last year.

What's more, our customers have a vote in the business of our cooperative. They elect the board members responsible for governing the Farm Credit Bank of Texas and benefit from the transparency inherent in our cooperative structure.

The bottom line is that the cooperative structure benefits the borrowers of the Farm Credit System. They own and govern their local lending institutions, which own and govern the wholesale bank — sharing the overhead costs and sharing the earnings. That's the co-op way.

SENIOR MANAGEMENT TEAM
FARM CREDIT BANK OF TEXAS

OUR OPERATIONS:

Larry Doyle, Chief Executive Officer (center)
Tom Hill, Senior Vice President,
Chief Financial Officer,
Chief Operations Officer (left)
Steve Fowlkes, Senior Vice President,
Chief Credit Officer

2008 FINANCIAL HIGHLIGHTS

For the Year (in thousands)	**2008**	2007	2006
Net interest income	**$119,396**	$ 99,565	$ 90,341
Provision for loan losses	**(20,529)**	(1,043)	(2,578)
Noninterest expense, net	**(22,134)**	(24,518)	(22,769)
Net income	**$ 76,733**	$ 74,004	$ 64,994
Rate of return on:			
Average assets	**0.54%**	0.55%	0.53%
Average shareholders' equity	**10.19**	10.56	10.07
Cash patronage paid	**$ 51,618**	$ 46,174	$ 37,043

At Year End (in millions)			
Total loans	**$ 11,403**	$ 10,866	$ 10,055
Total assets	**14,761**	13,521	12,916
Total liabilities	**14,016**	12,792	12,252
Total shareholders' equity	**745**	729	664
Permanent capital ratio	**14.03%**	13.43%	13.67%
Total surplus ratio	**11.25**	11.15	11.61
Core surplus ratio	**6.40**	6.70	6.93
Net collateral ratio	**105.40**	105.18	105.35

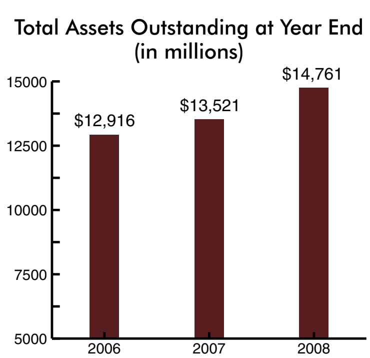
responsible, forward-thinking, results-oriented

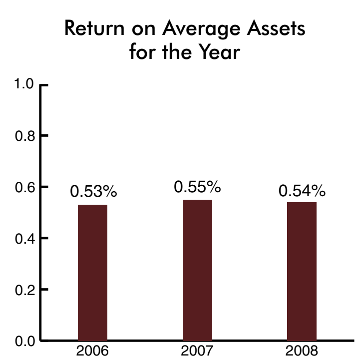
In spite of the many challenges posed by the global financial crisis and weakening economy in 2008, Farm Credit Bank of Texas remained healthy. We recorded solid earnings, modest loan volume growth and strong credit quality. At the same time, our return on assets and return on equity remained at very respectable levels.

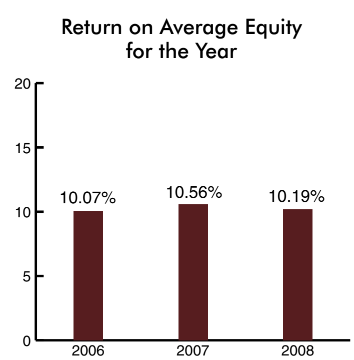
As a cooperative, Farm Credit Bank of Texas measures success by the value we return to our customer-owners. We are extremely pleased to report that we distributed a record $51.6 million in cash patronage and allocated $1.8 million in earnings to our customers. Combined, this $53.4 million represents almost 70 percent of our 2008 net income. In so doing, we were able to meet the credit needs of our lending associations at a net effective cost comparable to the bank's cost of funds.

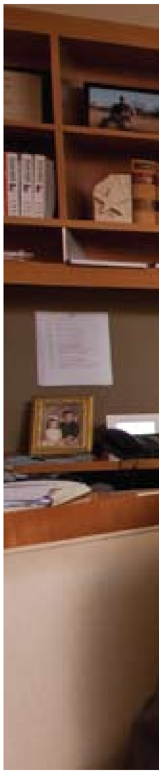
Results like these don't happen in tough times without a sharp focus on risk, debt and capital management. Some of our key strategies for managing the balance sheet, generating earnings and diversifying risk in 2008 included the following.

- Last summer, Farm Credit Bank of Texas achieved a key strategic goal when we received very favorable investment-grade ratings from Fitch Ratings and Moody's Investors Service — ratings that will be critical to our ability to raise capital when market conditions are favorable.
- In September, we improved our capital structure by issuing $50 million of subordinated debt in a private placement, bringing to $250 million the total amount of subordinated debt and preferred stock that we have issued since November 2003.
- As part of our diversification strategy, we sold approximately $800 million in direct notes to CoBank and reinvested the funds in our capital markets loan participation portfolio to broaden our risk base.
- To improve our net interest rate spread and margins, we restructured our debt obligations, executing call options on approximately $6.1 billion worth of debt, which we reissued at more favorable rates.
- Additionally, we worked with our local lending associations to help them evaluate their credit underwriting standards and adopt more market-focused loan pricing strategies to better control their risk.









A business is only as good as its people, and as our consistently strong results attest, Farm Credit Bank of Texas employs the best. Seasoned, knowledgeable and dedicated, our team of just under 200 employees works with focused determination to make our $14.8-billion cooperative a success.

Just as the diversity of our loan and investment portfolios contributes to our financial strength, the diversity of our people brings a diversity of ideas, creativity and experience to the bank.

During turbulent times like the financial sector experienced last year, experience is an essential rudder. We are fortunate to have a management team that has lived and worked through the up-and-down cycles in agriculture and banking. Our 13 senior managers average nearly 24 years of Farm Credit experience and 30 years of industry experience. They lead an innovative and talented staff of credit, financial, technical, legal, marketing and administrative professionals, who take pride in delivering great value to our customers.

We focus on hiring and retaining outstanding people, and providing them with the tools, training and technology they need to do their jobs well.

OUR PEOPLE:

In 2008, we enhanced our professional development and leadership training program by adding critical communications classes, expanding our supervisory training program and supporting employees' continuing education studies.

Our focus on people extends beyond the bank to the entire Tenth District family of lending cooperatives. Recognizing the importance of skills-training for all district personnel, in 2008 we also offered training in credit, rural appraisals, information technology, human resource management and marketing to employees of our customer cooperatives.

In addition, for the 11th consecutive year, we conducted our Director Development Program for association directors. Addressing topics ranging from governance to credit, this rigorous program attracted 331 board members from throughout the Tenth Farm Credit District and our neighboring AgFirst Farm Credit District.

knowledgeable, dedicated, experienced

OUR FUTURE: strategic, mission-oriented,

Bank Board Welcomes New Director Lester Little

Tenth Farm Credit District stockholders elected Lester Little of Hallettsville, Texas, to a three-year term on the Farm Credit Bank of Texas Board of Directors, effective January 1, 2009. He succeeds Kenneth Andrews, who retired December 31, 2008, after 15 years of service as a board member.

Prior to joining the bank board, Little was chairman of the Capital Farm Credit Board of Directors. He is a past vice chairman of the Tenth District Stockholders' Advisory Committee and served on the district's former Association Business Advisory Committee.

Little owns and operates a farm that is headquartered in Lavaca County, with operations in Jackson, Harris, Fort Bend and Brazoria counties. He also offers custom-farming services, primarily reclaiming farms and handling land preparation. A former Hallettsville ISD board chairman and former Lavaca Central Appraisal District board member, Little is active in agricultural and community organizations.

In recent years, the Farm Credit Bank of Texas has significantly improved profitability, customer service and operational efficiencies. In 2009, the focus of our attention will be to maintain this progress during challenging economic times and to keep our cooperative strong.

Earnings are one of the most important keys to our success, and to maintain our favorable agency ratings and our access to the credit markets, we must remain profitable. Under the current financial conditions, superior credit management is critical, both at the bank and association levels. In 2009, we will place a high priority on proper risk management. We also will help our associations to raise the bar on their lending practices, with emphasis on deep credit analysis, stringent loan underwriting, risk-based loan pricing and frequent loan servicing. The result, we believe, will be healthier cooperatives that will be poised to grow and prosper following the current economic slump.

As a federated cooperative, we demonstrate our commitment to our customers' success by providing them with financial products and market-driven business tools that help them to

committed to excellence

be competitive. In the near future, we will begin to implement our latest cutting-edge tool — a new credit delivery, analysis and loan accounting system. A significant investment in the future of the bank and the associations, the new system is expected to tremendously improve efficiency throughout the Tenth Farm Credit District.

As always, we will continue to provide the bank's expertise and support services in numerous other areas, including marketing, employee recruiting, compensation plans, cash management products, technology development and operational support.

For 92 years, Farm Credit Bank of Texas and our affiliated lending cooperatives have welcomed the opportunity and obligation to serve the credit needs of all types of agriculture. This year, especially, agriculture and rural America need a strong lender. It is a high calling that we will be proud to answer.

REPORT OF MANAGEMENT

The financial statements of the Farm Credit Bank of Texas (bank) are prepared by management, which is responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances, except as noted. Other financial information included in this annual report is consistent with that in the financial statements.

To meet its responsibility for reliable financial information, management depends on the bank'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. To monitor compliance, the internal audit staff of the Farm Credit Bank of Texas audits the accounting records, reviews accounting systems and internal controls, and recommends improvements as appropriate. The financial statements are audited by PricewaterhouseCoopers LLP (PwC), independent auditors, who also conduct a review of internal accounting controls to establish a basis for reliance thereon in determining the nature, extent and timing of the audit tests applied in the examination of the financial statements. In addition, the bank is examined annually by the Farm Credit Administration.

In the opinion of management, the financial statements are true and correct and fairly state the financial position of the Farm Credit Bank of Texas at December 31, 2008, 2007 and 2006. The independent auditors have direct access to the board, which is composed solely of directors who are not officers or employees of the bank.

The undersigned certify that we have reviewed the December 31, 2008, annual report of the Farm Credit Bank of Texas, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.

Ralph W. Cortese
Chairman of the Board

Larry R. Doyle
Chief Executive Officer

Thomas W. Hill
Senior Vice President, Chief Financial Officer,
Chief Operations Officer

February 27, 2009

REPORT OF AUDIT COMMITTEE

The Audit Committee (committee) is comprised of the entire board of directors of the Farm Credit Bank of Texas (bank). The committee oversees the scope of the bank's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those internal control activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on the bank's Web site at www.farmcreditbank.com. In 2008, six committee meetings were held. The committee approved the appointment of PricewaterhouseCoopers LLP (PwC) as independent auditors for 2008.

Management is responsible for the bank's internal controls and for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the bank's 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 these processes.

In this context, the committee reviewed and discussed the bank's audited financial statements for the year ended December 31, 2008 with management and PwC. The committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communications With Those Charged With Governance), and both PwC and the bank's internal auditor directly provided reports on significant matters to the committee.

The committee discussed with appropriate representatives of PwC the firm's independence from the bank. The committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining the independent accountant's independence. Furthermore, throughout 2008 the committee has discussed with management and PwC such other matters and received such assurances from them as the committee deemed appropriate.

William F. Staats, Chairman
Joe R. Crawford, Vice Chairman
Ralph W. Cortese
James F. Dodson
Elizabeth G. Flores
Jon M. Garnett
Lester Little

Audit Committee Members

February 27, 2009

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Farm Credit Bank of Texas' (bank's) principal executive and principal financial officer are responsible for establishing and maintaining adequate internal control over financial reporting for the bank's financial statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of, the bank's principal executive and principal financial officer, or persons performing similar functions, and effected by its boards of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the bank's assets that could have a material effect on its financial statements.

The bank's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2008. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the bank concluded that as of December 31, 2008, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the bank determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2008.

Larry R. Doyle
Chief Executive Officer

Thomas W. Hill
Senior Vice President, Chief Financial Officer,
Chief Operations Officer

February 27, 2009

REPORT OF INDEPENDENT AUDITORS

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
300 West Sixth Street
Suite 1800
Austin TX 78701
Telephone (512) 477 1300
Facsimile (512) 477 8681
www.pwc.com

Report of Independent Auditors

To the Board of Directors and Shareholders
of the Farm Credit Bank of Texas:

In our opinion, the accompanying balance sheets and the related statements of income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Farm Credit Bank of Texas (bank) 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 financial statements are the responsibility of the bank's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 27, 2009

FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

Farm Credit Bank of Texas

(dollars in thousands)	**2008**	2007	2006	2005	2004
Balance Sheet Data					
Cash, federal funds sold and overnight investments	**$ 189,791**	$ 142,102	$ 103,394	$ 46,836	$ 51,114
Investment securities	**3,028,468**	2,410,999	2,672,242	2,697,876	1,787,706
Loans	**11,403,113**	10,865,991	10,055,428	8,481,501	6,918,236
Less allowance for loan losses	**12,549**	1,065	142	142	239
Net loans	**11,390,564**	10,864,926	10,055,286	8,481,359	6,917,997
Other assets	**151,678**	102,751	84,838	58,717	44,388
Total assets	**$ 14,760,501**	$ 13,520,778	$ 12,915,760	$ 11,284,788	$ 8,801,205
Obligations with maturities of one year or less	**$ 6,099,922**	$ 4,797,803	$ 4,835,886	$ 5,371,770	$ 4,058,078
Obligations with maturities greater than one year	**7,916,037**	7,994,374	7,415,653	5,288,711	4,241,696
Total liabilities	**14,015,959**	12,792,177	12,251,539	10,660,481	8,299,774
Preferred stock	**200,000**	200,000	200,000	200,000	100,000
Capital stock	**227,212**	198,864	161,421	135,390	118,323
Retained earnings	**343,113**	334,394	324,270	315,047	290,666
Accumulated other comprehensive loss	**(25,783)**	(4,657)	(21,470)	(26,130)	(7,558)
Total shareholders' equity	**744,542**	728,601	664,221	624,307	501,431
Total liabilities and shareholders' equity	**$ 14,760,501**	$ 13,520,778	$ 12,915,760	$ 11,284,788	$ 8,801,205
Statement of Income Data					
Net interest income	**$ 119,396**	$ 99,565	$ 90,341	$ 75,960	$ 66,662
(Provision) negative provision for loan losses	**(20,529)**	(1,043)	(2,578)	344	7,878
Noninterest expense, net	**(22,134)**	(24,518)	(22,769)	(18,688)	(27,558)
Net income	**$ 76,733**	$ 74,004	$ 64,994	$ 57,616	$ 46,982
Financial Ratios (unaudited)					
Rate of return on:					
Average assets	**0.54%**	0.55%	0.53%	0.60%	0.59%
Average shareholders' equity	**10.19%**	10.56%	10.07%	10.57%	9.44%
Net interest income to average earning assets	**0.85%**	0.74%	0.74%	0.80%	0.85%
Net charge-offs to average loans	**0.08%**	<.01%	0.03%	—	0.03%
Total shareholders' equity to total assets	**5.04%**	5.39%	5.14%	5.53%	5.70%
Debt to shareholders' equity (:1)	**18.82**	17.56	18.44	17.08	16.55
Allowance for loan losses to total loans	**0.11%**	0.01%	—	—	—
Permanent capital ratio	**14.03%**	13.43%	13.67%	17.36%	19.82%
Total surplus ratio	**11.25%**	11.15%	11.61%	14.97%	16.55%
Core surplus ratio	**6.40%**	6.70%	6.93%	8.82%	11.51%
Net collateral ratio	**105.40%**	105.18%	105.35%	105.90%	105.69%
Net Income Distributions					
Net income distributions declared					
Preferred stock dividends	**$ 15,122**	$ 15,122	$ 15,122	$ 11,342	$ 7,561
Patronage distributions declared					
Cash	**$ 51,618**	$ 46,174	$ 37,043	$ 28,713	$ 16,775
Allocated earnings	**1,786**	1,586	1,058	837	14

AVERAGE BALANCES AND NET INTEREST EARNINGS

Farm Credit Bank of Texas
(unaudited)
December 31,

	2008			2007			2006		
(dollars in thousands)	**Average Balance**	**Interest**	**Average Rate**	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets									
Investment securities, federal funds sold and securities purchased under resale agreements	**$ 2,697,953**	**$ 110,966**	**4.11%**	$ 2,598,854	$ 131,768	5.07%	$ 2,929,742	$ 141,260	4.82%
Loans	**11,317,022**	**549,724**	**4.86**	10,780,754	621,773	5.77	9,246,083	511,297	5.53
Total interest-earning assets	**14,014,975**	**660,690**	**4.71**	13,379,608	753,541	5.63	12,175,825	652,557	5.36
Cash	**10,353**			4,745			4,365		
Accrued interest receivable	**47,643**			52,584			42,393		
Allowance for loan losses	**(5,669)**			(271)			(153)		
Other noninterest-earning assets	**66,970**			52,152			42,233		
Total average assets	**$ 14,134,272**			$ 13,488,818			$ 12,264,663		
Liabilities and Shareholders' Equity									
Bonds, medium-term notes and subordinated debt, net	**$ 11,541,763**	**$ 502,377**	**4.35%**	$ 11,718,042	$ 608,067	5.19%	$ 10,343,964	$ 506,346	4.90%
Discount notes, net, and other	**1,656,806**	**38,917**	**2.35**	920,095	45,909	4.99	1,137,866	55,870	4.91
Total interest-bearing liabilities	**13,198,569**	**541,294**	**4.10**	12,638,137	653,976	5.17	11,481,830	562,216	4.90
Noninterest-bearing liabilities	**182,582**			149,720			137,333		
Total liabilities	**13,381,151**			12,787,857			11,619,163		
Shareholders' equity and retained earnings	**753,121**			700,961			645,500		
Total average liabilities and shareholders' equity	**$ 14,134,272**			$ 13,488,818			$ 12,264,663		
Net interest rate spread		**$ 119,396**	**0.61%**		$ 99,565	0.46%		$ 90,341	0.46%
Net interest margin			**0.85%**			0.74%			0.74%

MANAGEMENT'S DISCUSSION & ANALYSIS

(DOLLARS IN THOUSANDS, EXCEPT AS OTHERWISE NOTED)

The following commentary is a discussion and analysis of the financial position and the results of operations of the Farm Credit Bank of Texas (the bank or FCBT) for the years ended December 31, 2008, 2007 and 2006. The commentary should be read in conjunction with the accompanying financial statements, notes to the financial statements (notes) and additional sections of this annual report. The accompanying financial statements were prepared under the oversight of the bank's Audit Committee.

The bank is part of the Tenth Farm Credit District (district), which is part of the federally chartered Farm Credit System (System). The bank provides funding to district associations, which, in turn, provide credit to their borrower-shareholders. As of December 31, 2008, the bank served six Federal Land Credit Associations (FLCAs), 13 Agricultural Credit Associations (ACAs) and certain Other Financing Institutions (OFIs). FLCAs and ACAs are collectively referred to as associations. See Note 1, "Organization and Operations," for an expanded description of the structure and operations of the bank.

Forward-Looking Information

This annual report 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.

Critical Accounting Policies

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

- **Allowance for loan losses** — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which identifies loans that may be impaired. Each of these individual loans are evaluated based on the borrower's overall financial condition, resources and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. If the present value of expected future cash flows (or, alternatively, the fair value of the collateral) is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), an impairment is recognized by making an addition to the allowance for loan losses with a corresponding charge to the provision for loan losses or by similarly adjusting an existing valuation allowance.
- **Valuation methodologies** — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other

postretirement benefit obligations, certain mortgage-related securities, and certain derivative and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the bank's results of operations.

- **Pensions** — The bank and its related associations participate in the district's defined benefit (DB) retirement plan. The plan is noncontributory, and benefits are based on salary and years of service. In addition, the bank and its related associations also participate in defined contribution retirement savings plans, and certain qualified individuals in the bank are eligible for participation in a separate nonqualified supplemental defined benefit pension plan or a separate nonqualified 401(k) plan. Pension expense for all plans is recorded as part of salaries and employee benefits.

  The structure of the district's DB plan is characterized as multi-employer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (bank and associations). No portion of any surplus assets is available to any participating employer, nor is any participating employer required to pay for plan liabilities upon withdrawal from the plan. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon combination only. The bank records current contributions to the DB plan as an expense in the current year.

  The supplemental defined benefit pension plan is not considered a multi-employer plan and is therefore recorded in these financial statements. For more information, see Note 9, "Employee Benefit Plans." Pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. We selected the discount rate by reference to Hewitt Associates' corporate bond index, actuarial analyses and industry norms.

OVERVIEW

General

The bank's loan portfolio grew to $11.4 billion in 2008, a 4.9 percent increase over the prior year. The bank's $2.7 million increase in net income for 2008 was driven by a 19.9 percent increase in net interest income. The net interest rate spread and net interest margin have improved, as well as the bank's efficiency, gauged by operating expenses as a percentage of net interest income and noninterest income. The passage of the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill), continued federal support of agriculture. However, continued growth has put additional pressure on capital ratios and strategies for the management of assets and capital adequacy. Adverse conditions in the general economy have impacted the last six months of 2008, resulting in a $75.7 million increase in impaired loans, and a $19.5 million increase in provisions for loan losses as compared to 2007.

Funding

The Farm Credit System continues to be a reliable source of debt capital for the farmers, ranchers and other rural businesses that we serve. However, the extraordinary instability of the global financial markets in the last six months and the negative economic developments of the last year have increased uncertainty about repayment capacity in the financial markets. The resulting reduction in investor willingness to invest in longer-term debt securities has reduced the System's ability to issue debt with preferred maturities and structures. Responses of the federal government to assist and protect commercial banks and the housing government-sponsored enterprises may have the unintended consequence of increasing our funding costs and further reducing our ability to issue debt with preferred maturities and structures.

Due the System's healthy financial position, it continues to enjoy a high demand for short-term debt securities at desirable rates, though the cost of issuing longer-term debt is expected to remain at higher levels. Although the bank has been able to augment its net interest rate spread with callable debt management and although district lending practices have adapted to financial market conditions by instituting loan pricing and structuring changes that more appropriately reflect these funding challenges, these current market pressures may compress net interest margins in the near term.

Agricultural Outlook

Although 2008 has been generally projected to be an exceptional year for American crop producers, results in the Tenth District have been significantly impacted by drought as well as by the effect of higher commodity prices and global demands. In the livestock market, which underlies 38 percent of the district's loan portfolio, drought, high feed costs, and reduced feeder cattle prices have resulted in increased cow slaughter, reducing expectations of beef production in the future. As the economic downturn became more prevalent in 2008, beef purchasing has shifted away from restaurant and commercial dining to increased home consumption. In a slowing economy, declining consumer meat demand may soften all protein prices. Poultry, bird slaughter and broiler production decreased in the fourth quarter of 2008, and the trend is expected to continue during most of 2009.

The Southwest region, which includes the western half of our district, was forecast to have its smallest upland cotton crop in five years, due to weather impact and the resulting significant abandonment. The Delta region's production was forecast to be 50 percent less than 2007, and is expected to be the lowest harvest since 1986. The Southeast region's modest increase was expected to be the only regional increase in production over 2007. Corn and feed grain crops, which have enjoyed higher prices in 2008, have started to soften as projections for feed, residual use and food, and ethanol use are being lowered.

While the district's agricultural economy faces these challenges, it does enjoy geographic and commodity diversity. Additionally, the bank's sale of participations in direct notes from district associations and reinvestment in a capital markets loan portfolio with increased diversity has further broadened its risk base. Government support programs also assist agricultural borrowers. While the district's loan portfolio has also enjoyed the enhancement of loans supported by off-farm income, some borrowers reliant on off-farm income may be adversely affected by the general economic downturn.

Financial Highlights

- The aggregate principal amount of loans outstanding at December 31, 2008, was $11.4 billion, compared to $10.9 billion at December 31, 2007, reflecting an increase of 4.9 percent over December 31, 2007.
- Net income totaled $76.7 million for the year ended December 31, 2008, an increase of 3.7 percent compared to 2007.
- Net interest income for the year ended December 31, 2008, was $119.4 million, a 19.9 percent increase over the year ended December 31, 2007.
- Return on average assets and return on average shareholders' equity for the year ended December 31, 2008, were 0.54 and 10.19 percent, respectively, compared to 0.55 and 10.56 percent for 2007, respectively.
- Approximately $800 million of participations in eight of the bank's direct notes with the district associations were sold, at par, to another System bank in 2008 for a total of $3.5 billion.
- Patronage distributions declared and earnings allocated totaled $53.4 million in 2008, compared to $47.8 million in 2007.

RESULTS OF OPERATIONS

Net Income

The bank's net income of $76,733 for the year ended December 31, 2008, reflects an increase of 3.7 percent over 2007, while 2007 income of $74,004 increased by 13.9 percent from 2006. The return on average assets was 0.54 percent for the year ended December 31, 2008, down from 0.55 percent reported for the year ended December 31, 2007. The return on average assets was 0.53 percent for the year ended December 31, 2006. Changes in the major components of net income for the referenced periods are outlined in the table and discussion on the following page.

	2008 vs. 2007	2007 vs. 2006
Net income (prior period)	$ 74,004	$ 64,994
Increase (decrease) due to:		
Interest income	(92,851)	100,984
Interest expense	112,682	(91,760)
Net interest income	19,831	9,224
Provision for loan losses	(19,486)	1,535
Noninterest income	11,784	4,269
Noninterest expense	(9,400)	(6,018)
Total change in net income	2,729	9,010
Net income	$ 76,733	$ 74,004

Discussion of the changes in components of net income is included in the following narrative.

Interest Income

Total interest income for the year ended December 31, 2008, was $660,690, a decrease of $92,851, or 12.3 percent, compared to 2007. Total interest income for 2007 was $753,541, an increase of $100,984, or 15.5 percent, from 2006. The decrease for 2008 over 2007 was due to the decreasing interest rate environment during 2008. The increase for 2007 over 2006 was due primarily to the increase in earning assets combined with the effects of the increasing interest rate environment that prevailed during most of 2007.

The following table illustrates the impact that volume and yield changes had on interest income over these periods.

	Year Ended December 31, 2008 vs. 2007	Year Ended December 31, 2007 vs. 2006
Increase in average earning assets	$ 635,367	$ 1,203,783
Average yield (prior year)	5.63%	5.36%
Interest income variance attributed to change in volume	35,771	64,523
Average earning assets (current year)	14,014,975	13,379,608
(Decrease) increase in average yield	(0.92)%	0.27%
Interest income variance attributed to change in yield	(128,622)	36,461
Net change in interest income	$ (92,851)	$ 100,984

Interest Expense

Total interest expense for the year ended December 31, 2008, was $541,294, a decrease of $112,682, or 17.2 percent, compared to the same period of 2007. Total interest expense for 2007 was $653,976, an increase of $91,760, or 16.3 percent, from 2006. The decrease for 2008 over 2007 was due primarily to the effects of the decreasing interest rate environment during 2008. The increase for 2007 over 2006 was due primarily to the increase in interest-bearing liabilities combined with the effects of the increasing interest rate environment that prevailed during most of 2007.

The following table illustrates the impact that volume and rate changes had on interest expense over these periods.

	Year Ended December 31, 2008 vs. 2007	Year Ended December 31, 2007 vs. 2006
Increase in average interest-bearing liabilities	$ 560,432	$ 1,156,307
Average rate (prior year)	5.17%	4.90%
Interest expense variance attributed to change in volume	28,974	56,659
Average interest-bearing liabilities (current year)	13,198,569	12,638,137
(Decrease) increase in average rate	(1.07)%	0.27%
Interest expense variance attributed to change in rate	(141,656)	35,101
Net change in interest expense	$ (112,682)	$ 91,760

Net Interest Income

Net interest income, the excess of interest income over interest expense, increased by $19,831 from 2007 to 2008, and increased by $9,224 from 2006 to 2007. The increase in 2008 was due to a $635.4 million increase in average interest-earning assets and a 15 basis point increase in the interest rate spread, which is the difference between the average rate received on interest-earning assets and the average rate paid on interest-bearing debt. Although there was considerable volatility in the financial markets from 2007 to 2008, the bank was able to improve its net interest rate spread and margin. During 2008 the bank called $6.087 billion in debt, replacing it with debt that had more favorable terms, which should continue to benefit the bank's net interest spread in 2009 and beyond.

Net interest income in 2007 was $9,224 greater than 2006. The increase in 2007 was due to a $1.2 billion increase in average interest-earning assets. There was no change in the interest rate spread and margin, despite the volatility in market interest rates from 2006 to 2007. During 2007 the bank called $2.535 billion in debt, replacing it with debt that had more favorable terms.

ANALYSIS OF NET INTEREST INCOME

	2008		2007		2006	
	Avg. Balance	**Interest**	Avg. Balance	Interest	Avg. Balance	Interest
Loans	**$ 11,317,022**	**$ 549,724**	$ 10,780,754	$ 621,773	$ 9,246,083	$ 511,297
Investments	**2,697,953**	**110,966**	2,598,854	131,768	2,929,742	141,260
Total earning assets	**14,014,975**	**660,690**	13,379,608	753,541	12,175,825	652,557
Interest-bearing liabilities	**13,198,569**	**541,294**	12,638,137	653,976	11,481,830	562,216
Impact of capital	**$ 816,406**		$ 741,471		$ 693,995	
Net Interest Income		**$ 119,396**		$ 99,565		$ 90,341

	2008 Average Yield	2007 Average Yield	2006 Average Yield
Yield on loans	**4.86%**	5.77%	5.53%
Yield on investments	**4.11%**	5.07%	4.82%
Yield on earning assets	**4.71%**	5.63%	5.36%
Cost of interest-bearing liabilities	**4.10%**	5.17%	4.90%
Interest rate spread	**0.61%**	0.46%	0.46%
Impact of capital	**0.24%**	0.28%	0.28%
Net interest income/average earning assets	**0.85%**	0.74%	0.74%

Provision for Loan Losses

In 2008, the bank recorded a $20,529 provision for loan losses on participation loans to seven borrowers, which was an increase of $19,486 from the provision for loan losses of $1,043 recorded in 2007. The provision for 2007 was a $1,535 decrease from the $2,578 provision for loan losses recorded in 2006. The provision for 2007 was primarily a $1.0 million provision related to participation loans to one borrower.

Noninterest Income

Noninterest income for the year ended December 31, 2008, was $33,900, an increase of $11,784, or 53.3 percent, compared to 2007. The increase is primarily attributable to a $10.5 million increase in patronage income from another System bank, a $2.1 million increase in gains on sale of investments, a $903 increase in fees for loan-related services, and a $517 increase in services billed to associations, offset by a $2.2 million loss recognized due to an other-than-temporary impairment on an investment security which is more fully discussed in "Investments."

Noninterest income for the year ended December 31, 2007, was $22,116, an increase of $4,269, or 23.9 percent, compared to 2006. The increase is primarily attributable to a $3.7 million increase in patronage income from another System bank, an $802 increase in patronage income from participation loans, and a $197 increase in all other income items, collectively, offset by a $508 decrease in fees for loan-related services.

Noninterest Expenses

Noninterest expenses totaled $56,034 for 2008, an increase of $9,400, or 20.2 percent, from 2007. This increase was primarily due to a $6,068 increase in salaries and employee benefits, a $2,168 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), a $216 increase in occupancy and equipment expenses, and a $953 increase in other operating expenses.

The $6.1 million increase in salaries and employee benefits was primarily due to a $3.1 million expense related to the settlement upon discontinuation of a key employee's participation in the Supplemental Pension Plan (see CEO compensation discussion in the Disclosure Information and Index section), a $1.4 million increase in compensation and related payroll taxes, a $1.5 million increase in other pension and retirement expenses, and an $81 increase in all other benefits. Compensation increased due to an increase in the number of employees and increases in compensation rates, as well as the costs associated with a retention plan.

The increase in premiums to the Insurance Fund is primarily due to the change to the FCSIC's new premium structure, assessed primarily on Systemwide debt effective July 1, 2008. Premiums were previously assessed on loan volume.

The increase in other operating expenses included a $309 increase in communication expenses, a $306 increase in Funding Corporation assessment fees, a $167 increase in allocated committee expenses, a $156 increase in supervisory and examination expenses, an $82 increase in travel expenses, and a $78 increase in all other expenses, collectively, offset by a $145 decrease in advertising and member relations expenses.

Noninterest expenses totaled $46,634 for 2007, an increase of $6,018, or 14.8 percent, from 2006. This increase was primarily due to a $2,705 increase in salaries and employee benefits, a $1,252 increase in premiums to the FCSIC, a $373 increase in occupancy and equipment expenses, a $1,655 increase in other operating expenses, and a $33 decrease in net gains on other property owned. The increase in salaries and employee benefits was due to a $2.3 million increase in compensation and related payroll taxes and a $314 increase in pension and retirement expenses. Compensation increased due to increases in the number of employees and increases in compensation rates, as well as employee retention expenses. Insurance Fund premiums increased due to an increase in the volume of loans on which FCSIC premiums are based. The increase in other operating expenses included an $875 increase in professional and contract service fees, a $465 increase in advertising and member relations expenses, a $243 increase in Farm Credit Council fees, and a $225 increase in examination fees, offset by a $153 decrease in all other expenses, collectively.

Operating expense (salaries and employee benefits, occupancy and equipment, Insurance Fund premiums and other operating expenses) statistics are set forth below for each of the three years ended December 31,

	2008	2007	2006
Excess of net interest income over operating expense	**$ 63,342**	$52,916	$49,677
Operating expense as a percentage of net interest income	**46.9%**	46.9%	45.0%
Operating expense as a percentage of net interest income and noninterest income	**36.6**	38.3	37.6
Operating expense as a percentage of average loans	**0.50**	0.43	0.44
Operating expense as a percentage of average earning assets	**0.40**	0.35	0.33

The bank's net interest income has increased 19.9 percent and 10.2 percent for the years ended December 31, 2008 and 2007, respectively, while operating expenses increased 20.2 percent for 2008 and 14.7 percent in 2007.

CORPORATE RISK PROFILE

Overview

The bank is in the business of making agricultural and other loans that requires us to take certain risks in exchange for compensation for the risks undertaken. Management of risks inherent in our business is essential for our current and long-term financial performance. Our goal is to mitigate risk, where appropriate, and to properly and effectively identify, measure, price, monitor and report risks in our business activities.

The major types of risk to which we have exposure are:

- **structural risk** — risk inherent in our business and related to our structure (an interdependent network of lending institutions);

- **credit risk** — risk of loss arising from an obligor's failure to meet the terms of its contract or failure to perform as agreed;
- **interest rate risk** — risk that changes in interest rates may adversely affect our operating results and financial condition;
- **liquidity risk** — risk of loss arising from the inability to meet obligations when they come due without incurring unacceptable losses;
- **operational risk** — risk of loss resulting from inadequate or failed internal processes or systems, errors by employees or external events; and
- **political risk** — risk of loss of support for the System and agriculture by the federal and state governments.

Structural Risk Management

Structural risk results from the fact that the bank, along with its related associations, is part of the Farm Credit System (System), which is comprised of banks and associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, this structure at times requires action by consensus or contractual agreement. Further, there is structural risk in that only the banks are jointly and severally liable for the payments of Systemwide debt securities. Although capital at the association level reduces a bank's credit exposure with respect to its direct loans to its affiliated associations, this capital may not be available to support the payment of principal and interest on Systemwide debt securities.

In order to mitigate this risk, we utilize two integrated contractual agreements — the Amended and Restated Contractual Interbank Performance Agreement, or CIPA, and the Amended and Restated Market Access Agreement, or MAA. Under provisions of the CIPA, a score is calculated that measures the financial condition and performance of each district using various ratios that take into account the district's and bank's capital, asset quality, earnings, interest-rate risk and liquidity. Based on these measures, the CIPA establishes an agreed-upon standard of financial condition and performance that each district must achieve and maintain.

Periodically, the ratios in the CIPA model are reviewed, with the assistance of an independent party, to take into consideration current performance standards in the financial services industry. In connection with the most recent review, effective January 1, 2005, certain ratios were revised to better reflect improved financial condition and performance in the financial services industry. In addition, the agreed-upon financial condition and performance standard was revised to conform to the trigger points in the MAA. The CIPA also establishes economic incentives whereby monetary penalties are applied if the performance standard is not met. These penalties will occur at the same point at which a bank would be required to provide additional monitoring information under the MAA.

The MAA establishes criteria and procedures for the banks — which are jointly and severally liable for the payment of Systemwide debt securities — that provide operational oversight and control over a bank's access to System funding if the creditworthiness of the bank declines below certain agreed-upon levels. The MAA promotes the identification and resolution of individual bank financial problems in a timely manner and discharges the Funding Corporation's statutory responsibility for determining conditions of participation for each bank's participation in each issuance of Systemwide debt securities.

Under the MAA, if certain financial criteria are not met, a bank may be placed in one of three categories, each of which imposes certain requirements and/or restrictions on the affected bank. The criteria under the MAA are the CIPA scores, the net collateral ratio and the permanent capital ratio of a bank. The bank net collateral ratio is net collateral (primarily earning assets) divided by total liabilities less subordinated debt, subject to certain limits, and the bank permanent capital ratio is primarily the bank's common, preferred stock, subordinated debt, subject to certain limits, and surplus divided by risk-adjusted assets. The criteria for the net collateral ratio and the permanent capital ratio are:

	Net Collateral Ratio	Permanent Capital Ratio
Category I	<104%	<8.0%
Category II	<103%	<7.0%
Category III	<102%	<5.0%

The categories are progressively more restrictive: a "Category I" bank is subject to additional monitoring and reporting requirements; with very limited exceptions, a bank in "Category II" will be allowed market access only to the extent necessary to roll over principal (net of any original issue discount) on maturing debt obligations; and a "Category III" bank may not be permitted to participate in issuances of Systemwide debt securities.

During the three years ended and as of December 31, 2008, all banks met the agreed-upon standard of financial condition and performance required by the CIPA, and none of the banks were placed in any of the three categories designated for banks failing to meet the MAA's specified financial criteria.

Credit Risk Management

Credit risk arises from the potential inability of an obligor to meet its repayment obligation and exists in our outstanding loans, letters of credit, unfunded loan commitments, investment portfolio and derivative counterparty credit exposures. We manage credit risk associated with our lending activities through an assessment of the credit risk profile of an individual borrower. We set our own underwriting standards and lending policies, approved by the board of directors, that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- **character** — borrower integrity and credit history;
- **capacity** — repayment capacity of the borrower based on cash flows from operations or other sources of income;
- **collateral** — protects the lender in the event of default and represents a potential secondary source of loan repayment;
- **capital** — ability of the operation to survive unanticipated risks; and
- **conditions** — intended use of the loan funds.

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based on cash flows from operations or other sources of income, including non-farm income. In addition, each loan is assigned a credit risk rating based on the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses and risks in a particular relationship.

This credit risk rating process uses a two-dimensional loan rating structure, incorporating a 14-point risk-rating scale to identify and track the probability of borrower default and a separate 4-point scale addressing loss given default. The 14-point risk rating scale provides for nine "acceptable" categories, one "other assets especially mentioned" category, two "substandard" categories, one "doubtful" category and one "loss" category. The loss given default scale establishes four ranges of anticipated economic loss if the loan defaults. The calculation of economic loss includes principal and interest as well as collections costs, legal fees and staff costs.

By buying and selling loans or interests in loans to or from other institutions within the System or outside the System, we limit our exposure to either a borrower or commodity concentration. This also allows us to manage growth and capital, and to improve geographic diversification.

Portfolio credit risk is also evaluated with the goal of managing the concentration of credit risk. Concentration risk is reviewed and measured by industry, product, geography and customer limits.

Loans

The bank's loan portfolio consists of direct notes receivable from district associations, loan participations purchased, loans to qualifying financial institutions serving agriculture and other loans. See Note 1, "Organization and Operations," and Note 4, "Loans and Allowance for Loan Losses," for further discussions.

Gross loan volume of $11.403 billion at December 31, 2008, reflected an increase of $537.1 million, or 4.9 percent, from December 31, 2007. The balance of $10.866 billion at December 31, 2007, reflected an increase of $811.0 million, or 8.1 percent, from the $10.055 billion balance at December 31, 2006.

The following table presents each loan category as a percentage of the total loan portfolio:

	December 31,		
	2008	2007	2006
Direct notes receivable from district associations and OFIs	**73.7%**	75.1%	78.6%
Participations purchased	**26.2**	24.7	21.1
Other loans	**0.1**	0.2	0.3
Total	**100.0%**	100.0%	100.0%

The following table discloses the credit quality of the bank's loan portfolio at December 31,

	2008	2007	2006
Acceptable	**97.2%**	98.2%	99.1%
Special mention	**1.7**	1.5	0.6
Substandard	**1.1**	0.3	0.3
Total	**100.0%**	100.0%	100.0%

Bank credit quality has remained strong during the past three years, with all association and OFI direct notes rated (under the Farm Credit Administration's Uniform Loan Classification System) as "acceptable" or "other assets especially mentioned" during this period. Credit quality for all loans other than direct notes to associations and OFIs classified as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable was 95.8, 98.7 and 98.9 percent at December 31, 2008, 2007 and 2006, respectively. Given the current adversity in the general economy some decline in the overall credit quality of the bank is anticipated.

While loan participations purchased made up only 26.2 percent of the bank's total loans at December 31, 2008, the bank has continued its initiative to increase the size of its participations portfolio. To this end, in 2008, the bank sold, at par, an additional $800 million of participations in eight of its direct notes receivable from associations to another System bank, for a total of $3.5 billion. The purpose of the sales was to diversify the credit exposure of the bank by providing capital for liquidity and expansion of the capital markets loan participations portfolio.

Association Direct Notes

As the preceding table illustrates, 73.7 percent of the bank's portfolio consisted of direct notes from associations and OFIs at December 31, 2008. Terms of loans to associations and OFIs are specified in a separate general financing agreement between each association and OFI and the bank, and all assets of each association secure the direct notes to the bank. Each association is a federally chartered instrumentality of the United States and is regulated by the Farm Credit Administration (FCA). See Note 1, "Organization and Operations," for further discussion of the Farm Credit System.

The credit exposure of the bank's loans to associations, which are evidenced by direct notes with full recourse, is dependent on the associations' creditworthiness and the ability of their borrowers to repay loans made to them. The credit risk to the bank is mitigated by diversity in the associations' loan portfolios in terms of underlying collateral and income sources, geography, and range of individual loan amounts. In addition, the risk-bearing capacities of the associations are assessed annually by the bank and are currently deemed adequate to absorb most interest-related shocks. Each association maintains an allowance for loan losses determined by its management and is capitalized to serve its unique market area. Associations are subject to FCA regulations concerning minimum capital, loan underwriting and portfolio management, and are audited annually by independent accountants.

District associations have experienced significant loan growth over the last three years. The district's loan growth is attributed to increased focus on market share and opportunities within the territory, competitive pricing offered by the bank and associations, increased marketing and customer service efforts by the associations, and continued activity in loan participations with district and outside entities. Loan growth in the associations is funded substantially by, and therefore results in, association direct note growth at the bank. Government support of agriculture, the availability of off-farm income sources and utilization of guarantees have helped to diminish the effects of adverse economic conditions for the district's associations.

The diversity of commodities underlying the district's credit portfolio is reflected in the following table:

	Percentage of Portfolio		
Commodity Group	**2008**	2007	2006
Livestock	**38%**	40%	38%
Crops	**14**	14	13
Timber	**11**	12	12
Cotton	**5**	5	5
Poultry	**4**	4	4
Dairy	**3**	3	4
Rural home	**1**	1	1
Other	**24**	21	23
Total	**100%**	100%	100%

The diversity of states underlying the district's loan portfolio is reflected in the following table:

	December 31,		
	2008	2007	2006
Texas	**59%**	62%	63%
Alabama	**7**	6	7
Mississippi	**6**	6	6
Louisiana	**4**	4	4
Florida	**3**	3	3
All other states	**21**	19	17
Total	**100%**	100%	100%

Direct notes from the associations in Texas represent the majority of the bank's direct notes from all district associations. However, these notes are collateralized by a diverse loan portfolio, both in terms of geography and underlying commodities, which helps to mitigate the concentration risk often associated with one state or locale. Associations in each state have commodity diversification that is being augmented by increased purchases of loan participations.

The district's loans by size are shown in the following table at December 31:

Size (thousands)	**2008**	2007	2006
< $250	**27%**	29%	31%
$250-$500	**12**	12	12
$500-$1,000	**13**	12	12
$1,000-$5,000	**27**	26	26
$5,000-$25,000	**17**	17	16
$25,000-$100,000	**4**	4	3
Total	**100%**	100%	100%

Credit quality at the district's associations at December 31, 2008, 2007 and 2006 remained strong, with greater than 97 percent classified as "acceptable" or "other assets especially mentioned" as a percentage of total loans for each of the three year ends. Association non-earning assets as a percentage of total loans at December 31, 2008, were 1.8 percent, compared to 0.7 percent and 0.4 percent at December 31, 2007 and 2006, respectively.

High-Risk Assets

The following table discloses the components of the bank's high-risk assets at December 31,

	2008	2007	2006
Nonaccrual loans	**$ 109,662**	$ 23,923	$ 3,713
Formally restructured loans	**690**	715	885
Loans past due 90 days or more and still accruing interest	**—**	9,999	—
Total	**$110,352**	$ 34,637	$ 4,598

High-risk assets increased by $75,715 from December 31, 2007, to $110,352 at December 31, 2008. The increase in nonaccrual loans is attributable to the addition during 2008 of $87.3 million in nine participation loans. The additions included a poultry credit of $53.2 million and an ethanol credit totaling $8.4 million. The poultry producer filed for bankruptcy protection during the fourth quarter of 2008 as a result of higher feed costs and reduced demand for poultry. The ethanol credit related to a large ethanol producer and its wholly-owned subsidiaries, which filed for bankruptcy protection in the fourth quarter of 2008. These loans are generally adequately collateralized but, where appropriate, provisions for loan losses have been recorded. The decrease in loans past due 90 days or more and still accruing interest was due to one participation loan that was paid in full during 2008. At December 31, 2008, $93,333, or 85.1 percent, of loans classified as nonaccrual were current as to principal and interest, compared to $23,923 (100.0 percent) and $3,671 (98.9 percent) at December 31, 2007 and 2006, respectively. Volatility in the agricultural commodity market and increases in farm input costs have resulted in higher risk profiles for livestock, grain producers, and borrowers who use corn and other grains in their products. Due to these higher risk profiles and the impact of volatility in the general economic environment, the bank anticipates credit quality of the loan portfolio may continue to decline in 2009.

Allowance for Loan Losses

The allowance for loan losses at December 31, 2008, was $12,549, compared to $1,065 at December 31, 2007 and $142 at December 31, 2006. Because analysis indicates that an allowance on the association direct notes is not warranted, the entire balance of the allowance for loan losses reflects reserves for risks identified in the bank's participations and other loan portfolios.

The following table provides an analysis of key statistics related to the allowance for loan losses at December 31,

	2008	2007	2006
Allowance for loan losses as a percentage of:			
Average loans	**0.11%**	0.01%	<0.01%
Loans at year end			
Total loans	**0.11**	0.01	<0.01
Participations	**0.42**	0.04	<0.01
Nonaccrual loans	**11.44**	4.45	3.82
Total high-risk loans	**11.37**	3.07	3.09
Net charge-offs to average loans	**0.08**	<0.01	0.03
Provision expense to average loans	**0.18**	0.01	0.03

The activity in the allowance for loan losses is discussed further in Note 4, "Loans and Allowances for Loan Losses."

Interest Rate Risk Management

Asset/liability management is the bank's process for directing and controlling the composition, level and flow of funds related to the district's interest-rate-sensitive assets and liabilities. Management's objective is to generate adequate and stable net interest income in a changing interest rate environment.

The bank uses a variety of techniques to manage the district's financial exposure to changes in market interest rates. These include monitoring the difference in the maturities or repricing cycles of interest-rate-sensitive assets and liabilities; monitoring the change in the market value of interest-rate-sensitive assets and liabilities under various interest rate scenarios; and simulating changes in net interest income under various interest rate scenarios.

The interest rate risk inherent in a district association's loan portfolio is substantially mitigated through its funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process. Under the Farm Credit Act of 1971, as amended, a district association is obligated to borrow only from the bank unless the bank approves borrowing from other funding sources. An association's indebtedness to the bank, under a general financing agreement between the bank and the association, represents demand borrowings by the association to fund the majority of its loan advances to association members.

The bank's net interest income is determined by the difference between income earned on loans and investments and the interest expense paid on funding sources, typically Systemwide bonds, medium-term notes, discount notes and subordinated debt. The bank's level of net interest income is affected by both changes in market interest rates and timing differences in the maturities or repricing cycles of interest-rate-sensitive assets and liabilities.

Depending upon the direction and magnitude of changes in market interest rates, the bank's net interest income may be affected either positively or negatively by the mismatch in the maturity or the repricing cycle of interest-rate-sensitive assets and liabilities.

The bank's asset/liability management process establishes controls for determining the composition of interest-rate-sensitive assets and liabilities. The bank is able to manage the balance sheet composition by using various debt issuance strategies and hedging transactions to match its asset structure. Management's objective is to maintain adequate and stable net interest income in any interest rate environment.

FCBT maintains a loan pricing perspective that loan rates should be based on competitive market rates of interest. The district associations offer a wide variety of products, including LIBOR- and prime-indexed variable-rate loans and loans with fixed-rate terms ranging from under one year to 30 years. The interest rates on these loans are directly related to the bank's cost to issue debt in the capital markets.

The bank offers an array of loan programs to associations that are designed to meet the needs of associations' borrowers. These loan programs have flexible repayment terms, including fixed and level principal payments, and a choice of payment frequencies, such as monthly, quarterly, semi-annual and annual payments. Additionally, the bank offers a choice of early prepayment options to meet customer needs.

FCBT uses high-level complex modeling tools to manage and measure the risk characteristics of its earning assets and liabilities, including gap and simulation analyses. The following interest rate gap analysis sets forth the bank's interest-earning assets and interest-bearing liabilities outstanding as of December 31, 2008, which are expected to mature or reprice in each of the future time periods shown:

INTEREST RATE GAP ANALYSIS

as of December 31, 2008

	Interest-Sensitive Period						
	One Month or Less	Over One Through Six Months	Over Six Through Twelve Months	**Total Twelve Months or Less**	Over One Year but Less Than Five Years	Over Five Years and Non-Rate-Sensitive	**Total**
Interest-Earning Assets							
Total loans	$ 2,699,072	$ 2,160,577	$ 1,371,669	**$ 6,231,318**	$ 4,584,761	$ 587,034	**$ 11,403,113**
Total investments	1,079,373	610,373	500,903	**2,190,649**	957,512	57,005	**3,205,166**
Total interest-earning assets	3,778,445	2,770,950	1,872,572	**8,421,967**	5,542,273	644,039	**14,608,279**
Interest-Bearing Liabilities							
Total interest-bearing funds*	3,653,705	3,967,000	2,520,000	**10,140,705**	2,906,000	755,500	**13,802,205**
Excess of interest-earning assets over interest-bearing liabilities	—	—	—	**—**	—	806,074	**806,074**
Total interest-bearing liabilities	3,653,705	3,967,000	2,520,000	**10,140,705**	2,906,000	1,561,574	**$ 14,608,279**
Interest rate sensitivity gap	$ 124,740	$ (1,196,050)	$ (647,428)	**$ (1,718,738)**	$ 2,636,273	$ (917,535)	
Cumulative interest rate sensitivity gap	$ 124,740	$ (1,071,310)	$ (1,718,738)	**$ (1,718,738)**	$ 917,535		

* The impact of interest rate swaps is included with interest-bearing funds.

The amount of assets or liabilities shown in each of the time periods was determined based on the earlier of repricing date, contractual maturity or anticipated loan prepayments. Additionally, adjustments have been made to reflect the characteristics of callable debt instruments and the impact of derivative transactions. The "interest rate sensitivity gap" line reflects the mismatch, or gap, in the maturity or repricing of interest-rate-sensitive assets and liabilities. A gap position can be either positive or negative. A positive gap indicates that a greater volume of assets than liabilities reprices or matures in a given time period, and conversely, a negative gap indicates that a greater volume of liabilities than assets reprices or matures in a given time period. On a 12-month cumulative basis, the bank has a negative gap position, indicating that the bank has an exposure to increasing interest rates. This would occur when interest expense on interest-bearing liabilities increases due to their maturing or repricing cycle sooner than maturing or repricing assets. The cumulative gap, which is a static measure, does not take into consideration the changing value of options available to the bank in order to manage this exposure, specifically the ability to exercise or not exercise options on callable debt. These options are considered when projecting the effects of interest rate changes on net income and on the market value of equity in the following tables.

To reflect the expected cash flow and repricing characteristics of the bank's balance sheet, an estimate of expected prepayments on loans is used to adjust the maturities of the loans in the earning assets section of the gap analysis. Changes in market interest rates will affect the volume of prepayments on loans. Correspondingly, adjustments have been made to reflect the characteristics of callable debt instruments and the effect derivative financial instruments have on the repricing structure of the bank's balance sheet.

Interest rate risk exposure is measured by simulation modeling, which calculates the bank's expected net interest income based upon projections of interest-rate-sensitive assets and liabilities, derivative financial instruments and interest rate scenarios. The bank monitors its financial exposure to multiple interest rate scenarios. The bank's policy guideline for the maximum negative impact to the bank's net interest income is 16 percent for a 200 basis point change in interest rates. Per FCA regulations, when the current 3-month Treasury bill interest rate is less than 4 percent, the minus 200 basis point scenario should be replaced with a downward shock equal to one-half of the 3-month Treasury bill rate. The bank manages its interest rate risk exposure well within this guideline. As of December 31, 2008, projected annual net interest income of the existing interest-earning assets and interest-bearing liabilities would decrease by $16,042, or 10.28 percent, if interest rates were to increase by 100 basis points, and would increase by $809, or 0.52 percent, if interest rates were to decrease by 6 basis points.

Utilizing simulation analysis, the bank projects net interest income and market value of equity under multiple interest rate scenarios. The following tables set forth FCBT's projected annual net interest income and market value of equity for interest rate movements as prescribed by policy as of December 31, 2008, based on the bank's interest-earning assets and interest-bearing liabilities at December 31, 2008.

Net Interest Income

Scenario	Net Interest Income	% Change
+ 200 BP Shock	$ 156,363	0.22%
+ 100 BP Shock	139,982	(10.28)
0 BP	156,024	—
– 6 BP Shock*	156,833	0.52

Market Value of Equity

Scenario	Assets	Liabilities	Equity	% Change
Book value	$14,760,501	$14,015,959	$744,542	13.23%
+ 200 BP Shock	14,367,620	13,781,455	586,165	(10.85)
+ 100 BP Shock	14,679,030	14,053,888	625,142	(4.93)
0 BP Shock	14,950,224	14,292,692	657,532	—
– 6 BP Shock*	14,964,732	14,305,350	659,382	0.28

*When the 3-month Treasury bill is below 4.00%, the shock-down 200 scenario is replaced with a shock down equal to half of the 3-month Treasury bill.

The bank uses derivative financial instruments to manage its interest rate risk and liquidity position. Fair value and cash flow interest rate swaps for asset/liability management purposes are used to change the repricing characteristics of liabilities to match the repricing characteristics of the assets they support. The bank does not hold, and is restricted by policy from holding, derivative financial instruments for trading purposes and is not a party to leveraged derivative transactions.

At December 31, 2008, the bank had four fair value interest rate swap contracts with a total notional amount of $350 million. The interest rate swap contracts had a net fair value of $31.4 million, which is reflected in other assets. In addition, the bank had four cash flow interest rate swaps with a total notional amount of $450 million; these cash flow hedges had a net liability fair value of $3.1 million at December 31, 2008. To the extent that its derivatives have a negative fair value, the bank has a payable on the instrument, and the counterparty is exposed to the credit risk of the bank. To the extent that its derivatives have a positive fair value, the bank has a receivable on the instrument and is therefore exposed to credit risk from the counterparty. To manage this credit risk, the bank monitors the credit ratings of its counterparties and has bilateral collateral agreements with counterparties. The bank's activity in derivative financial instruments for 2008 is summarized in the table below:

Activity in Derivative Financial Instruments
(Notional Amounts)

(in millions)	
Balance, December 31, 2007	$ 925
Additions	200
Maturities/calls	(325)
Balance, December 31, 2008	**$ 800**

Liquidity Risk Management

The bank's liquidity risk management practices ensure the district's ability to meet its financial obligations. These obligations include the repayment of Systemwide debt securities as they mature, the ability to fund new and existing loan and other funding commitments, and the ability to fund operations in a cost-effective manner. A primary objective of liquidity risk management is to plan for unanticipated changes in the capital markets.

Funding Sources

The bank's primary source of liquidity is the ability to issue Systemwide debt securities, which are the general unsecured joint and several obligations of the System banks. The bank continually raises funds to support its mission to provide credit and related services to the rural and agricultural sectors, repay maturing Systemwide debt securities, and meet other obligations. As a government-sponsored enterprise, the bank has had access to the nation's and world's capital markets. This access has provided us with a dependable source of competitively priced debt that is critical to support our mission of providing funding to the rural and agricultural sectors. Moody's Investors Service and Standard & Poor's rate the System's long-term debt as Aaa and AAA, and our short-term debt as P-1 and A-1+. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's government-sponsored enterprise status. Material changes to the factors considered could result in a different debt rating. However, as a result of the System's financial performance, credit quality and standing in the capital markets, we anticipate continued access to funding necessary to support System needs. The U.S. government does not guarantee, directly or indirectly, Systemwide debt securities.

The types and characteristics of securities are described in Note 7, "Bonds and Notes." As a condition of the bank's participation in the issuance of Systemwide debt securities, the bank is required by regulation to maintain specified eligible assets as collateral in an amount equal to or greater than the total amount of bonds and notes outstanding for which the bank is liable. At December 31, 2008, the bank had excess collateral of $770.6 million. Management expects the bank to maintain sufficient collateral to permit its continued participation in Systemwide debt issuances in the foreseeable future.

In September 2008, the bank issued $50.0 million in subordinated debt in a private placement to one investor. The debt is a 10-year instrument with a coupon rate of 8.406 percent. The bank confirmed its determination that the subordinated debt will receive preferential regulatory capital and collateral treatment, being includible in permanent capital and total surplus and being excludible from total liabilities for purposes of net collateral ratio calculation. These preferential treatments will be ratably removed 20 percent per year during years six to 10 of the debt's term.

During 2008, the bank received ratings from two rating agencies. In August 2008, Moody's Investors Service upgraded the bank's issuer rating to Aa2 from the Aa3 rating it had issued in July 2008. In addition, the bank's A2 preferred stock rating was affirmed and the bank received an A1 subordinated debt rating. In June 2008, Fitch Ratings, Ltd. issued an AA-long-term issuer default rating with a stable rating outlook and assigned an A rating to the bank's preferred stock.

The following table provides a summary of the period-end balances of the debt obligations of the bank:

(dollars in millions)	December 31, 2008	2007	2006
Bonds and term notes outstanding	**$ 11,335**	$ 11,464	$ 11,354
Average effective interest rates	**3.89%**	4.98%	5.04%
Average remaining life (years)	**3.4**	3.2	2.7
Subordinated debt outstanding	**$ 50**	$ —	$ —
Average effective interest rates	**8.50%**	—	—
Average remaining life (years)	**9.8**	—	—
Discount notes outstanding	**$ 2,467**	$ 1,160	$ 767
Average effective interest rates	**1.37%**	4.10%	5.23%
Average remaining life (days)	**107**	39	29

The following table provides a summary of the average balances of the debt obligations of the bank:

	For the years ended December 31, 2008	2007	2006
Average interest-bearing liabilities outstanding	**$ 13,199**	$ 12,638	$ 11,482
Average interest rates on interest-bearing liabilities	**4.10%**	5.17%	4.90%

Liquidity Standard

FCBT's liquidity management objectives are to provide a reliable source of funding for borrowers, meet maturing debt obligations and fund operations in a cost-effective manner. The bank maintains an investment portfolio comprised primarily of high-quality liquid securities. The securities provide a stable source of income for the bank, and their high quality ensures the portfolio can quickly be converted to cash should the need arise.

The System banks have jointly developed and adopted a common minimum liquidity standard (standard). This standard is designed to maintain and assure adequate liquidity to meet the business and financial needs of each bank and the System. The standard requires each bank to maintain a minimum of 90 days of liquidity on a continuous basis, assuming no access to the capital markets. The number of days of liquidity is calculated by comparing maturing Systemwide debt securities and other bonds with the total amount of cash, investments and other liquid assets maintained by the bank. For purposes of calculating liquidity, liquid assets are subject to discounts that reflect potential exposure to adverse market value changes that might be recognized upon liquidation or sale. At December 31, 2008, the bank had 134 days of liquidity coverage, as compared with 121 days at December 31, 2007.

The bank maintains a $150.0 million commercial bank committed line of credit to support possible general short-term credit needs.

Investments

As permitted under FCA regulations, a bank is authorized to hold eligible investments (including federal funds) for the purposes of maintaining a diverse source of liquidity, profitably managing short-term surplus funds, and managing interest rate risk. During 2005, the FCA approved a rule that increased the amount of eligible investments a bank is authorized to hold to an amount not to exceed 35 percent of loans outstanding from the previous percentage of 30 percent.

FCA regulations also define eligible investments by specifying credit rating criteria, final maturity limit and percentage of investment portfolio limit for each investment type. Generally, the banks' investments must be highly rated by a Nationally Recognized Statistical Rating Organization, such as Moody's Investors (Moody's) Service or Standard & Poor's. A bank must dispose of an investment that becomes ineligible within six months, unless the FCA grants permission to divest the instrument over a longer period of time.

As of December 31, 2008, the bank's investment portfolio consisted of the following:

	Amount	Percent of Total
Federal agency collateralized mortgage obligations	$ 1,681,033	52%
Other collateralized mortgage obligations	192,581	6
Agency debt	500,957	16
Corporate debt	382,061	12
Money market instruments	154,255	5
Asset-backed securities	67,041	2
Overnight investments	176,698	5
Total available-for-sale investments	3,154,626	98
Mission-related investments	50,540	2
Total	$ 3,205,166	100%

The bank's available-for-sale investments are reflected at fair value. The mission-related investments are held-to-maturity and are reflected at amortized cost.

At December 31, 2008, the bank had two investments which were ineligible for liquidity purposes as a result of credit downgradings. One asset-backed investment in sub-prime mortgages had credit ratings at December 31, 2008, of Baa1 and BB by Moody's and Standard and Poor's, respectively. This investment had an amortized cost of $4.1 million and a fair value of $2.2 million, with an unrealized loss of $1.9 million at December 31, 2008. In May 2008, the FCA approved the bank's plan of divestiture for this downgraded investment, which indicated the bank's desire to continue to hold the investment. In addition, one of the bank's whole-loan mortgage-backed investments was downgraded to Baa1 and B by Moody's and Standard and Poor's in December 2008, respectively. Using detailed cash flow analysis, the bank determined that this security had an impairment that was other than temporary, and as a result, the investment's amortized cost of $14.9 million was written down to its fair value of $12.7 million, resulting in a realized loss of $2.2 million for 2008. The downgrading of the whole-loan mortgage-backed security requires a submission of a plan of divestiture to the FCA and their formal approval. The plan of divestiture was submitted on February 10, 2009. While these investments do not meet the FCA's standards for liquidity, they are included in the net collateral calculation, albeit at their lower market value rather than the normal book value for qualifying investments. Due to the continued deterioration in the mortgage markets, the bank may have additional other than temporary impairments on non-guaranteed mortgage- and asset-backed securities.

The bank's liquidity investment portfolio included $59.3 million of money market holdings in The Reserve U.S. Government Fund (Government Fund). This fund was composed of short-term senior debt securities issued by Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Association (Freddie Mac), Federal Home Loan Bank and the Farm Credit System. Effective September 18, 2008, the Securities and Exchange Commission (SEC) issued an order, at the request of The Reserve, to suspend all rights of redemption on its Government Fund and other funds. The Reserve was experiencing heavy redemption requests on its funds. The SEC's goal was to ensure an orderly disposition of the securities in the Government Fund to maintain the integrity of the fund's Net Asset Value (NAV) of $1.00 per share. Subsequent to year end, on January 16, 2009, the bank received the remainder of its principal balance, along with accrued interest on the investment security.

Capital Adequacy

Total shareholders' equity at December 31, 2008, was $744,542, compared to $728,601 and $664,221 at December 31, 2007 and 2006, respectively. The increase during 2008 was due primarily to net income of $76.7 million, and $28.4 million in capital stock issued, offset by patronage of $51.6 million, $21.1 million in decreases to accumulated other comprehensive income, dividends paid on preferred stock totaling $15.1 million, and the retirement of $940 of allocated retained earnings. The bank's $53.4 million in declared patronage included $34.4 million in direct loan patronage, $11.8 million patronage on certain participations, and $7.2 million patronage based on the associations' and OFIs' stock investment in the bank.

The bank recorded a $406 charge to retained earnings pursuant to a change in the measurement date used for the valuation of pension and other postretirement benefit obligations from September 30 to December 31 in 2008.

Accumulated other comprehensive loss increased $21.1 million, or 453.6 percent, to $25.8 million at December 31, 2008, from $4.7 million at December 31, 2007, due to an increase of $16.1 million in unrealized net losses on the bank's investments, and a charge to accumulated other comprehensive loss of $934 related to unamortized balances related to retirement benefits, net of a decrease of $4.1 million in unrealized gains on the bank's cash flow hedges. The increases in unrealized net losses on investments were primarily due to the effect of rising market interest rates on fixed-rate mortgage-backed securities in the bank's investment portfolio and illiquidity of certain mortgage-related investments. The $4.1 million decrease of unrealized gains on cash flow hedges is the result of decreases in the fair value of the four cash flow hedges the bank held at December 31, 2008.

In 2008, the bank sold an additional $800 million of participations in eight of its direct notes receivable from district associations to another System bank. The purpose of these sales was to diversify the credit exposure of the bank by providing capital for liquidity and expansion of the capital markets loan participation portfolio.

Capital adequacy is evaluated using various ratios for which the FCA has established regulatory minimums. The following table reflects the bank's capital ratios at December 31,

	2008	2007	2006	Regulatory Minimum
Permanent capital ratio	**14.03%**	13.43%	13.67%	7.00%
Total surplus ratio	**11.25**	11.15	11.61	7.00
Core surplus ratio	**6.40**	6.70	6.93	3.50
Collateral ratio	**105.40**	105.18	105.35	103.00

For additional information about the bank's capital, see Note 8, "Shareholders' Equity."

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. The board of directors is required, by regulation, to adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs and resources. The policy must include, at a minimum, the following items:

- direction to management that assigns responsibility for the internal control function to an officer of the institution;
- adoption of internal audit and control procedures;
- direction for the operation of a program to review and assess its assets;

- adoption of loan, loan-related assets and appraisal review standards, including standards for scope of review selection and standards for work papers and supporting documentation;
- adoption of asset quality classification standards;
- adoption of standards for assessing credit administration, including the appraisal of collateral; and
- adoption of standards for the training required to initiate a program.

In general, we address operational risk through the organization's internal framework under the supervision of the internal auditors. Exposure to operational risk is typically identified with the assistance of senior management, and internal audit plans are developed with higher risk areas receiving more review.

Political Risk Management

We, as part of the System, are an instrumentality of the federal government and are intended to further governmental policy concerning the extension of credit to or for the benefit of agricultural and rural America. The System and its borrowers may be significantly affected by federal legislation that affects the System directly, such as changes to the Farm Credit Act, or indirectly, such as agricultural appropriations bills. Political risk to the System is the risk of loss of support for the System or agriculture by the U.S. government.

We manage political risk by actively supporting The Farm Credit Council (Council), which is a full-service, federal trade association representing the System before Congress, the Executive Branch and others. The Council provides the mechanism for "grassroots" involvement in the development of System positions and policies with respect to federal legislation and government actions that impact the System. Additionally, we take an active role in representing the individual interests of System institutions and their borrowers before Congress. In addition to The Farm Credit Council, each district has its own council, which is a member of the Council. The district councils represent the interests of their members on a local and state level, as well as on a federal level.

Recent 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," 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 bank is currently evaluating the impact of adoption on its financial statement disclosures.

Regulatory Matters

During the year ended December 31, 2008, the FCA took no enforcement actions against the bank or its related associations, and there were no enforcement actions in effect for the bank or its related associations at December 31, 2008.

On October 31, 2007, the Farm Credit Administration published an advanced notice of public rule-making in the Federal Register with respect to the consideration of possible modifications to the Farm Credit Administration's risk-based capital rules for Farm Credit System institutions that are similar to the standardized approach delineated in the Basel II Framework. The Farm Credit Administration is seeking comments to facilitate the development of a proposed rule that would enhance their regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. Comments on the advanced notice of public rule-making were originally due by March 31, 2008; the comment period was extended to December 31, 2008. The System is in the process of developing a comment letter to provide to the Farm Credit Administration on the advanced notice of public rule-making.

Other

On September 30, 2008, the bank, in concert with the four other System banks, purchased senior cumulative perpetual preferred stock of the Federal Agricultural Mortgage Corporation (Farmer Mac). The bank's investment is $7.0 million of the $60.0 million total invested by System banks. The investment enabled Farmer Mac to strengthen its capital position and comply with its minimum regulatory capital requirements. The investment is not considered part of the bank's liquidity investment portfolio and is included in other assets at cost.

BALANCE SHEETS

Farm Credit Bank of Texas

(dollars in thousands)	December 31, 2008	2007	2006
Assets			
Cash	**$ 13,093**	$ 16,600	$ 14,165
Federal funds sold and overnight investments	**176,698**	125,502	89,229
Investment securities	**3,028,468**	2,410,999	2,672,242
Loans	**11,403,113**	10,865,991	10,055,428
Less allowance for loan losses	**12,549**	1,065	142
Net loans	**11,390,564**	10,864,926	10,055,286
Accrued interest receivable	**63,632**	66,789	63,967
Premises and equipment, net	**6,772**	2,719	2,286
Other assets	**81,274**	33,243	18,585
Total assets	**$ 14,760,501**	$ 13,520,778	$ 12,915,760
Liabilities and Shareholders' Equity			
Liabilities			
Bonds and notes, net	**$ 13,802,205**	$ 12,624,015	$ 12,120,783
Subordinated debt	**50,000**	—	—
Accrued interest payable	**96,847**	110,188	96,550
Other liabilities	**66,907**	57,974	34,206
Total liabilities	**14,015,959**	12,792,177	12,251,539
Commitments and contingencies (Note 11)			
Shareholders' Equity			
Preferred stock	**200,000**	200,000	200,000
Capital stock	**227,212**	198,864	161,421
Allocated retained earnings	**6,114**	5,196	6,194
Unallocated retained earnings	**336,999**	329,198	318,076
Accumulated other comprehensive loss	**(25,783)**	(4,657)	(21,470)
Total shareholders' equity	**744,542**	728,601	664,221
Total liabilities and shareholders' equity	**$ 14,760,501**	$ 13,520,778	$ 12,915,760

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

STATEMENTS OF INCOME

Farm Credit Bank of Texas

(dollars in thousands)	2008	Year Ended December 31, 2007	2006
Interest Income			
Investment securities	**$ 110,966**	$ 131,768	$ 141,260
Loans	**549,724**	621,773	511,297
Total interest income	**660,690**	753,541	652,557
Interest Expense			
Bonds, notes and subordinated debt	**541,294**	653,976	562,216
Net Interest Income	**119,396**	99,565	90,341
Provision for loan losses	**20,529**	1,043	2,578
Net interest income after provision for loan losses	**98,867**	98,522	87,763
Noninterest Income			
Patronage income	**17,471**	7,003	1,237
Fees for services to associations	**9,435**	8,918	8,856
Fees for loan-related services	**6,051**	5,148	5,656
Net gain on investment securities	**318**	503	907
Miscellaneous income, net	**625**	544	1,191
Total noninterest income	**33,900**	22,116	17,847
Noninterest Expenses			
Salaries and employee benefits	**28,955**	22,887	20,182
Occupancy and equipment	**5,139**	4,923	4,550
Insurance Fund premiums	**5,968**	3,800	2,548
Gains on other property owned	**(20)**	(15)	(48)
Other operating expenses	**15,992**	15,039	13,384
Total noninterest expenses	**56,034**	46,634	40,616
Net Income	**$ 76,733**	$ 74,004	$ 64,994

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Farm Credit Bank of Texas

(dollars in thousands)	Preferred Stock	Capital Stock	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2005	$ 200,000	$ 135,390	$ 8,742	$ 306,305	$ (26,130)	$ 624,307
Comprehensive income						
Net income	—	—	—	64,994	—	64,994
Net change in unrealized net losses on investment securities	—	—	—	—	5,707	5,707
Net change in unrealized net losses on cash flow hedge derivatives	—	—	—	—	(1,047)	(1,047)
Total comprehensive income	—	—	—	64,994	4,660	69,654
Capital stock issued	—	26,031	—	—	—	26,031
Capital stock and allocated retained earnings retired	—	—	(3,606)	—	—	(3,606)
Cash dividends – preferred stock	—	—	—	(15,122)	—	(15,122)
Patronage						
Cash	—	—	—	(37,043)	—	(37,043)
Shareholders' equity	—	—	1,058	(1,058)	—	—
Balance at December 31, 2006	200,000	161,421	6,194	318,076	(21,470)	664,221
Comprehensive income						
Net income	—	—	—	74,004	—	74,004
Net change in unrealized net losses on investment securities	—	—	—	—	16,513	16,513
Net change in unrealized net gains on cash flow hedge derivatives	—	—	—	—	1,047	1,047
Total comprehensive income	—	—	—	74,004	17,560	91,564
Adjustment to initially apply SFAS 158	—	—	—	—	(747)	(747)
Capital stock issued	—	37,444	—	—	—	37,444
Capital stock and allocated retained earnings retired	—	(1)	(2,584)	—	—	(2,585)
Cash dividends – preferred stock	—	—	—	(15,122)	—	(15,122)
Patronage						
Cash	—	—	—	(46,174)	—	(46,174)
Shareholders' equity	—	—	1,586	(1,586)	—	—
Balance at December 31, 2007	200,000	198,864	5,196	329,198	(4,657)	728,601
Adjustment for accounting changes:						
Change in measurement date – SFAS No. 158	—	—	—	(406)	—	(406)
Balance at January 1, 2008	200,000	198,864	5,196	328,792	(4,657)	728,195
Comprehensive income						
Net income	—	—	—	76,733	—	76,733
Change in pension and postretirement benefit plans	—	—	—	—	(934)	(934)
Net change in unrealized net losses on investment securities	—	—	—	—	(16,071)	(16,071)
Net change in unrealized net gains on cash flow hedge derivatives	—	—	—	—	(4,121)	(4,121)
Total comprehensive income	—	—	—	76,733	(21,126)	55,607
Capital stock issued	—	28,420	—	—	—	28,420
Capital stock and allocated retained earnings retired	—	(72)	(868)	—	—	(940)
Cash dividends – preferred stock	—	—	—	(15,122)	—	(15,122)
Patronage						
Cash	—	—	—	(51,618)	—	(51,618)
Shareholders' equity	—	—	1,786	(1,786)	—	—
Balance at December 31, 2008	**$ 200,000**	**$ 227,212**	**$ 6,114**	**$ 336,999**	**$ (25,783)**	**$ 744,542**

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

STATEMENTS OF CASH FLOWS

Farm Credit Bank of Texas

(dollars in thousands)	Year Ended December 31, 2008	2007	2006
Cash Flows From Operating Activities			
Net income	$ 76,733	$ 74,004	$ 64,994
Reconciliation of net income to net cash provided by operating activities			
Provision for loan losses	20,529	1,043	2,578
Depreciation on premises and equipment	1,153	904	793
Accretion of net discount on loans	(348)	(464)	(187)
Amortization and accretion on debt instruments	(2,240)	(1,759)	(660)
Accretion of net (discount) premium on investments	(1,405)	(3,004)	3,626
Gain on sale of investment securities	(2,556)	(503)	(907)
Loss on impairment of available-for-sale investment	2,238	—	—
Gain on sales of other property owned, net	(20)	(15)	(48)
(Gain) loss from sales of premises and equipment	(2)	2	12
Decrease (increase) in accrued interest receivable	3,157	(2,822)	(19,973)
Increase in other assets, net	(9,675)	(7,494)	(3,279)
(Decrease) increase in accrued interest payable	(13,341)	13,638	36,437
Increase in other liabilities, net	3,181	12,590	3,040
Net cash provided by operating activities	77,404	86,120	86,426
Cash Flows From Investing Activities			
Net increase in federal funds sold and securities purchased under resale agreements	(51,196)	(36,273)	(46,785)
Investment securities			
Purchases	(4,319,450)	(3,971,804)	(6,666,471)
Proceeds from maturities, calls and prepayments	3,570,847	4,159,943	6,587,280
Proceeds from sales	116,785	93,123	107,814
Investment in Farmer Mac preferred stock	(7,000)	—	—
Allocated equity patronage from System bank	(6,408)	(1,972)	(2,361)
Increase in loans, net	(1,346,476)	(2,098,658)	(2,576,270)
Proceeds from sale of loans	800,000	1,300,000	1,000,000
Proceeds from sales of premises and equipment	2	108	59
Expenditures for premises and equipment	(5,206)	(1,447)	(661)
Net cash used in investing activities	(1,248,102)	(556,980)	(1,597,395)
Cash Flows From Financing Activities			
Bonds and notes issued	57,398,132	31,248,805	28,809,507
Subordinated debt issued, net of cost	49,458	—	—
Bonds and notes retired	(56,243,332)	(30,751,324)	(27,261,180)
Capital stock issued	28,420	37,444	26,031
Capital stock retired and allocated retained earnings distributed	(940)	(2,585)	(3,606)
Cash dividends on preferred stock	(15,122)	(15,122)	(15,122)
Cash patronage distributions paid	(49,425)	(43,923)	(34,888)
Net cash provided by financing activities	1,167,191	473,295	1,520,742
Net (decrease) increase in cash	(3,507)	2,435	9,773
Cash at beginning of year	16,600	14,165	4,392
Cash at End of Year	$ 13,093	$ 16,600	$ 14,165
Supplemental Schedule of Noncash Investing and Financing Activities			
Net (increase) decrease in unrealized losses on investment securities	$ (16,071)	$ 16,513	$ 5,707
Declared participations patronage payable	9,994	7,802	5,551
Supplemental Schedule of Noncash Changes in Fair Value Related to Hedging Activities			
Increase in bonds and notes	$ 25,630	$ 7,510	$ 9,837
Supplemental Disclosure of Cash Flow Information			
Interest paid	$ 554,635	$ 640,338	$ 525,779

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

NOTES TO FINANCIAL STATEMENTS

Farm Credit Bank of Texas

(dollars in thousands, except per share amounts and as otherwise noted)

Note 1 — Organization and Operations

A. Organization:

The Farm Credit Bank of Texas (FCBT or bank) is one of the banks of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations established by acts of Congress. The System is currently subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

The United States is served by four Farm Credit Banks (FCBs), each of which has specific lending authority within its chartered territory, and one Agricultural Credit Bank (ACB), (collectively, the "System banks") which has nationwide lending authority for lending to cooperatives. The ACB also has the lending authorities of an FCB within its chartered territories. The bank is chartered to serve the states of Alabama, Louisiana, Mississippi, New Mexico and Texas.

Each FCB and the ACB serve one or more Federal Land Credit Associations (FLCAs) and/or Agricultural Credit Associations (ACAs). The district's six FLCAs, 13 ACA parent associations, each containing two wholly-owned subsidiaries (an FLCA and a Production Credit Association [PCA]), certain Other Financing Institutions (OFIs), and preferred stockholders jointly owned the bank at December 31, 2008. FLCAs and ACAs collectively are referred to as associations. The bank and its related associations collectively are referred to as the Tenth Farm Credit District (district).

Each FCB and the ACB provides funding for its district associations and is responsible for supervising the activities of the associations within its district. The FCBs and/or associations make loans to or for the benefit of eligible borrower-stockholders for qualified agricultural and rural purposes. District associations borrow the majority of their funds from their related bank. The System banks obtain a substantial majority of funds for their lending operations through the sale of consolidated Systemwide bonds and notes to the public, but also obtain a portion of their funds from internally generated earnings, from the issuance of common and preferred stock and, to a lesser extent, from the issuance of subordinated debt.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the bank and associations. The activities of the bank and associations are examined by the FCA, and certain actions by these entities are subject to the FCA's prior approval.

B. Operations:

The Farm Credit Act sets forth the types of authorized lending activities and financial services which can be offered by the bank and defines the eligible borrowers which it may serve.

The bank lends primarily to the district associations in the form of revolving lines of credit (direct notes) to fund the associations' loan portfolios. These direct notes are collateralized by a pledge of substantially all of each association's assets. The terms of the revolving direct notes are governed by a general financing agreement between the bank and each association. Each advance is structured so that the principal cash flow, repricing characteristics and underlying index (if any) of the advance match those of the assets being funded. By match-funding the association loans, the interest rate risk is effectively transferred to the bank. Advances are also made to fund general operating expenses of the associations. FLCAs borrow money from the bank and, in turn, originate and service long-term real estate and agribusiness loans to their members. ACAs borrow from the bank and in turn originate and service long-term mortgage loans through the FLCA subsidiary and short- and intermediate-term loans through the PCA subsidiary. The OFIs borrow from the bank and in turn originate and service short- and intermediate-term loans to their members. An association's indebtedness to the bank, under a general financing agreement between the bank and the association, represents demand borrowings by the association to fund the majority, but not all, of its loan advances to association member-borrowers.

In addition to providing loan funds to district associations, the bank also provides banking and support services to them, such as accounting, information systems and marketing. The fees charged by the bank for these services are included in the bank's noninterest income.

The bank is also authorized to provide, 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 bank may also lend to qualifying financial institutions engaged in lending to eligible borrowers.

The bank, in conjunction with other banks in the System, jointly owns several service organizations which were created to provide a variety of services for the System. The bank has ownership interests in the following service organizations:

- Federal Farm Credit Banks Funding Corporation (Funding Corporation) — provides for the issuance, marketing and processing of Systemwide debt securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.
- Farm Credit System Building Association — leases premises and equipment to the FCA, as required by the Farm Credit Act.
- Farm Credit System Association Captive Insurance Company — as a reciprocal insurer, provides insurance services to its member organizations.

These ownership interests are accounted for using the cost method. In addition, The Farm Credit Council acts as a full-service, federated trade association which represents the System before Congress, the Executive Branch and others, and provides support services to System institutions on a fee basis.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used to (1) insure the timely payment of principal and interest on Systemwide debt obligations (insured debt), (2) 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 Insurance Corporation, of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. 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 assets 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 such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. 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 System 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.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the bank conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires the management of the bank to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are discussed in these notes as applicable. Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

The accompanying financial statements include the accounts of the bank and reflect the investments in and allocated earnings of the service organizations in which the bank has partial ownership interests. The multi-employer structure of certain retirement and benefit plans of the district results in the recording of these plans only in the combined financial statements of the district.

A. Cash:

Cash, as included in the financial statements, represents cash on hand and on deposit at banks.

B. Investment Securities and Federal Funds:

The bank, as permitted under FCA regulations, holds eligible investments for the purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk.

Most of the bank's investments are to be held for an indefinite time period and, accordingly, have been classified as available for sale at December 31, 2008, 2007 and 2006. These investments are reported at fair value, and unrealized holding gains and losses are netted and reported as a separate component of shareholders' equity in the balance sheet. Changes in the fair value of investments are reflected as direct charges or credits to other comprehensive income, unless the investment is deemed to be other-than-temporarily impaired. If an investment is deemed to be other-than-temporarily impaired, the cost basis of the investment is written down to its fair value and an impairment loss is recorded in earnings in the period of impairment. Purchased premiums and discounts are amortized or accreted using an effective interest method over the term of the respective issues. Realized gains and losses are determined using the specific identification method and are recognized in current operations.

During May 2008 the bank purchased mission-related rural housing mortgage-backed securities which constitute the bank's held-to-maturity investment portfolio. These securities are not marked to market and have an amortized cost basis of $50.5 million and a fair market value of $51.6 million; they are not included in the bank's liquidity calculations.

The bank reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other than temporary. In the event of other-than-temporary impairment, the cost basis of the investment would be written down to its fair value, and the loss would be included in current earnings. The bank may also hold additional investments in accordance with mission-related investment programs, approved by the Farm Credit Administration.

The bank's holdings in investment securities are more fully described in Note 3, "Investment Securities."

C. Loans and Allowance for Loan Losses:

Loans are carried at their principal amount outstanding less any unearned income or unamortized discount. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding. Funds which are held by the bank on behalf of the borrowers, where legal right of setoff exists and which can be used to reduce outstanding loan balances at the bank's discretion, are netted against loans in the balance sheet.

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

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 full collection of principal and interest is in doubt. In accordance with FCA regulations, all loans 180 days or more past due are considered nonaccrual. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if current year interest) or charged against the allowance for loan losses (if prior year interest).

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, payments are recognized as interest income. Nonaccrual loans may be returned to accrual status when contractual principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss." If previously unrecognized interest income exists upon reinstatement of a nonaccrual loan to accrual status, interest income will only be recognized upon receipt of cash payments applied to the loan.

In cases where a borrower experiences financial difficulties and the bank 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.

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," 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. The bank capitalizes origination fees, premiums and discounts in excess of $50 thousand and amortizes them over the lives of the related loans on a straight-line basis, which does not yield results that are materially different from the effective interest method.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan portfolio. A specific allowance may be established for impaired loans under SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral-dependent.

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

D. Other Property Owned:

Other property owned, consisting of real and personal property acquired through foreclosure or other collection action, is recorded at fair value, based on appraisal, less estimated selling costs upon acquisition. Revised estimates to the fair value, established by appraisal, 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 losses (gains) on other property owned, net.

E. Premises and Equipment:

Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is calculated using the straight-line method over the estimated useful lives of 40 years for buildings and improvements; three to 10 years for furniture, equipment and certain leasehold improvements; and three to four years for automobiles. Computer software and hardware are amortized over three years. Gains and losses on dispositions are reflected currently. Maintenance and repairs are charged to operating expense, and improvements are capitalized and amortized over the remaining useful life of the asset.

F. Other Assets and Other Liabilities:

Direct expenses incurred in issuing debt are deferred and amortized using the prospective level yield method over the term of related indebtedness.

The bank is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the bank on such balances. There were no significant balances of ACPs at December 31, 2008, 2007 and 2006.

Derivative financial instruments are included on the balance sheet at fair value, as either other assets or other liabilities.

G. Employee Benefit Plans:

Substantially all employees of the bank participate in one of two districtwide retirement plans (a defined benefit plan and a defined contribution plan) and are eligible to participate in the 401(k) plan of the district. Within the 401(k) plan, a certain percentage of employee contributions is matched by the bank. The 401(k) plan costs are expensed as incurred. Additionally, certain qualified individuals in the bank may participate in a separate, nonqualified supplemental defined benefit pension plan or in a separate, nonqualified 401(k) plan.

The structure of the district's defined benefit plan (DB plan) is characterized as multi-employer, since neither the assets, liabilities nor cost of the plan is segregated or separately accounted for by participating employers (bank and associations). No portion of any surplus assets is available to any participating employer, nor is any participating employer required to pay for plan liabilities upon withdrawal from the plan. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon combination only. The bank records current contributions to the DB plan as an expense in the current year. As described more fully in Note 9, "Employee Benefit Plans," the bank's supplemental pension plan is accounted for and reported in accordance with SFAS No. 87, "Employers' Accounting for Pensions," SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," SFAS No. 132, "Employers' Disclosures About Pensions and Other Postretirement Benefits," and SFAS No. 158, "Employers' Accounting for Defined Benefit Pension Plans and Other Postretirement Benefits" (SFAS 158).

In addition to pension benefits, the bank 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. Bank employees hired after January 1, 2004, will be eligible for retiree medical benefits for themselves and their spouses but will be responsible for 100 percent of the related premiums.

H. Income Taxes:

The bank is exempt from federal and certain other income taxes as provided in the Farm Credit Act.

I. Derivative Instruments and Hedging Activity:

The bank is party to derivative financial instruments and cash flow hedges, consisting of interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. Derivatives are recorded on the balance sheet as assets and liabilities, measured at fair value.

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, for fair-value hedge transactions which hedge changes in the fair value of assets, liabilities or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash flow hedges, which hedge the exposure to variability in expected future cash flows, changes in the fair value of the derivative will generally be offset by an entry to accumulated other comprehensive income in shareholders' equity. The bank formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific liabilities on the balance sheet. The bank uses interest rate swaps whose critical terms match the corresponding hedged item, thereby qualifying for short-cut treatment under the provisions of SFAS No. 133, and are presumed to be highly effective in offsetting changes in the fair value. The bank would discontinue hedge accounting prospectively if it was determined that a hedge has not been or is not expected to be effective as a hedge. In the event that hedge accounting were discontinued and the derivative remained outstanding, the bank would carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

J. Fair Value Measurements:

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. Assets held in trust funds relate to deferred compensation and our supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

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.

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. 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.

The fair value disclosures have been expanded in accordance with SFAS No. 157, as disclosed in Note 13, "Fair Value Measurements."

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," 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 bank is currently evaluating the impact of adoption on its financial statement disclosures.

Note 3 — Investment Securities

A summary of the amortized cost and estimated fair value of investment securities at December 31, 2008, 2007 and 2006, follows:

	December 31, 2008				
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Agency debt	**$ 500,000**	**$ 957**	**$ 0**	**$ 500,957**	**3.54%**
Commercial paper and other	**536,970**	**1,490**	**(2,144)**	**536,316**	**0.84**
Federal agency collateralized mortgage obligations	**1,661,323**	**22,313**	**(1,709)**	**1,681,033**	**4.58**
Other collateralized mortgage obligations	**227,165**	**—**	**(35,478)**	**192,581**	**4.80**
Asset-backed securities	**73,499**	**—**	**(6,458)**	**67,041**	**4.17**
Total available-for sale-investments	**$ 2,998,957**	**$24,760**	**$(45,789)**	**$ 2,977,928**	**3.74%**
Held-to-maturity investments:					
Mission related	**$ 50,540**	**$ 1,103**	**$ 0**	**$ 51,643**	**4.98%**

	December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper and other	$ 399,265	$ 14	$ (964)	$ 398,315	4.60%
Federal agency collateralized mortgage obligations	1,502,436	10,899	(5,284)	1,508,051	4.98
Other collateralized mortgage obligations	296,552	22	(2,891)	293,683	5.06
Asset-backed securities	217,703	—	(6,753)	210,950	5.13
Total	$ 2,415,956	$10,935	$(15,892)	$ 2,410,999	4.93%

	December 31, 2006				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper and other	$ 366,173	$ 83	$ (29)	$ 366,227	5.36%
Federal agency collateralized mortgage obligations	1,556,467	1,142	(19,307)	1,538,302	4.80
Other collateralized mortgage obligations	387,375	199	(3,896)	383,678	5.09
Asset-backed securities	383,697	406	(68)	384,035	5.60
Total	$ 2,693,712	$ 1,830	$(23,300)	$ 2,672,242	5.04%

A summary of contractual maturity, amortized cost, estimated fair value and weighted average yield of investment securities at December 31, 2008, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
Due in one year or less	$ 904,238	$ 904,278	1.97%
Due after one year through five years	294,197	296,896	3.50
Due after five years through 10 years	296,803	296,943	3.85
Due after 10 years	1,503,719	1,479,811	4.71
Total available securities	$ 2,998,957	$ 2,977,928	3.74%
Mission related:			
Due after 10 years	$ 50,540	$ 51,643	4.98%

Collateralized mortgage obligations (CMOs) have stated contractual maturities in excess of 15 years. However, the security structure of the CMOs is designed to produce a relatively short-term life. At December 31, 2008, the CMO portfolio had a weighted average remaining life of approximately two years.

Proceeds and related gains and losses on investment securities follow:

	Year Ended December 31,		
	2008	2007	2006
Proceeds on sales	**$ 114,424**	$ 93,123	$ 107,814
Realized gains on sales	**2,556**	503	907
Realized losses due to impairment	**2,238**	—	—

The net realized gain is included in the statements of income as part of total noninterest income.

At December 31, 2008, the bank had 83 investments that were in a loss position. The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category, and the length of time the securities have been in a continuous unrealized loss position at December 31, 2008. The continuous loss position is based on the date the impairment occurred.

	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Collateralized mortgage obligations	$ 404,984	$ (23,836)	$ 60,853	$ (13,351)
Commercial paper	99,988	(12)	77,867	(2,133)
Asset-backed securities	—	—	67,041	(6,458)
Total available	$ 504,972	$ (23,848)	$ 205,761	$ (21,942)

The bank evaluates investment securities for other-than-temporary impairment on a quarterly basis. Factors considered in determining whether an impairment is other than temporary include: 1) the length of time and the extent to which the fair value is less than cost; 2) the credit ratings, financial condition and near-term prospects of the issuer; 3) the estimated cash flow projections compared to contractual cash flows; and 4) our ability and intent to hold these investments for a period of time sufficient to collect all amounts due according to the contractual terms of the investments. Analysis in the fourth quarter of 2008 resulted in a determination that one of the bank's whole-loan mortgage-backed investments had an impairment that was considered other than temporary. The whole-loan mortgage-backed investment was downgraded to Baa1 and B by Moody's and Standard and Poor's, respectively, during 2008. Using more detailed cash flow analysis, the bank determined that the investment's impairment was other than temporary, and as a result, the investment's amortized cost of $14.9 million was written down to its fair value of $12.6 million, resulting in a realized loss of $2.2 million for 2008.

Other investments in loss positions consisted predominantly of mortgage-backed securities and asset-backed securities classified as available-for-sale. The current unrealized loss positions principally resulted from changes in market interest rates and a decrease in liquidity in the marketplace, and not primarily from deterioration in credit quality. The bank has the ability and intent to hold these securities for a period of time sufficient to recover all gross unrealized losses, and thus the securities are not considered to be other-than-temporarily impaired at December 31, 2008.

Note 4 — Loans and Allowance for Loan Losses

Loans comprised the following categories at December 31:

	2008	2007	2006
Direct notes receivable from district associations and OFIs	**$ 8,402,595**	$ 8,158,458	$ 7,905,292
Participations purchased	**2,984,414**	2,682,262	2,121,173
Other loans	**16,104**	25,271	28,963
Total loans	**$ 11,403,113**	$ 10,865,991	$ 10,055,428

A substantial portion of the bank's loan portfolio consists of direct notes receivable from district associations. As described in Note 1, "Organization and Operations," these notes are used by the associations to fund their loan portfolios, and therefore the bank's implicit concentration of credit risk in various agricultural commodities approximates that of the district as a whole. Loan concentrations are considered to exist when there are amounts loaned to borrowers engaged in similar activities, which could cause them to be similarly impacted by economic or other conditions. The percentages below represent the district portfolio's diversification of credit risk as it relates to recorded loan principal. A substantial portion of the associations' lending activities is collateralized and the associations' exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the bank's credit risk exposure is considered in the bank's allowance for loan losses.

The district's concentration of credit risk in various agricultural commodities is shown in the following table at December 31:

Commodity	**2008**	2007	2006
Livestock	**38%**	40%	38%
Crops	**14**	14	13
Timber	**11**	12	12
Cotton	**5**	5	5
Poultry	**4**	4	4
Dairy	**3**	3	4
Rural home	**1**	1	1
Other	**24**	21	23
Total	**100%**	100%	100%

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loans. Interest income recognized and cash payments received on nonaccrual impaired loans are applied in a similar manner as for nonaccrual loans, as described in Note 2, "Summary of Significant Accounting Policies."

The following table presents information concerning nonaccrual loans, accruing restructured loans and accruing loans 90 days or more past due, collectively referred to as "impaired loans." Restructured loans are loans whose terms have been modified and on which concessions have been granted because of borrower financial difficulties. The bank's impaired loans consisted of participations purchased and other loans; no direct notes to district associations were impaired at December 31, 2008, 2007 and 2006.

	December 31,		
	2008	2007	2006
Nonaccrual loans			
Current as to principal and interest	**$ 93,333**	$ 23,923	$ 3,671
Past due	**16,329**	—	42
Total nonaccrual loans	**109,662**	23,923	3,713
Impaired accrual loans			
Restructured accrual loans	**690**	715	885
Accrual loans 90 days or more past due	**—**	9,999	—
Total impaired accrual loans	**690**	10,714	885
Total impaired loans	**$ 110,352**	$ 34,637	$ 4,598
Average impaired loans	**$ 36,449**	$ 11,217	$ 4,907

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 for the years ended December 31:

	2008	2007	2006
Interest income recognized on nonaccrual loans	**$ 96**	$ 292	$ 1,054
Interest income on impaired accrual loans	**119**	447	138
Interest income recognized on impaired loans	**$ 215**	$ 739	$ 1,192

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

	2008	2007	2006
With related specific allowance	**$ 41,189**	$ 16,296	$ 2,016
With no related specific allowance	**69,163**	18,341	2,582
Total impaired loans	**$ 110,352**	$ 34,637	$ 4,598
Allowance on impaired loans	**$ 12,549**	$ 1,065	$ 142

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

	2008	2007	2006
Interest income which would have been recognized under the original loan terms	**$ 3,693**	$ 1,299	$ 1,658
Less: interest income recognized	**215**	739	1,192
Foregone interest income	**$ 3,478**	$ 560	$ 466

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

	December 31,		
	2008	2007	2006
Balance at beginning of year	**$ 1,065**	$ 142	$ 142
Provision for loan losses	**20,529**	1,043	2,578
Loans charged off	**(9,148)**	(217)	(2,834)
Recoveries	**224**	97	256
Other	**(121)**	—	—
Balance at end of year	**$ 12,549**	$ 1,065	$ 142

The $9.1 million charge-off in 2008 was on participation loans to an ethanol borrower. The $121 "other" deduction is the provision for loan losses on unused commitments to that borrower, which are recorded as an other liability.

To mitigate risk of loan losses, district associations have entered into long-term standby commitments to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac) through an arrangement with the bank. The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the associations the right to sell the loans identified in the agreements to the bank, who can, in turn, sell them to Farmer Mac in the event of default, subject to certain conditions. The balance of loans under long-term standby commitments to purchase was $512.2 million at December 31, 2008. Fees paid to Farmer Mac for such commitments are paid by the associations.

In 2008, the bank sold an additional $800 million of participations in eight of its direct notes receivable from district associations to another System bank for a total of $3.5 billion. The purpose of these sales was to diversify the credit exposure of the bank by providing capital for liquidity and expansion of the capital markets loan participations portfolio.

Note 5 — Premises and Equipment

Premises and equipment comprised the following at:

	December 31,		
	2008	2007	2006
Leasehold improvements	**$ 1,056**	$ 948	$ 937
Furniture and equipment	**11,856**	7,272	6,235
	12,912	8,220	7,172
Accumulated depreciation	**(6,140)**	(5,501)	(4,886)
Total	**$ 6,772**	$ 2,719	$ 2,286

Included in the bank's property and equipment at December 31, 2008, is $3.3 million in capitalized costs related to the bank's development of new lending systems. The new systems will enhance the accounting and informational capabilities related to district association lending as well as the bank's capital markets loan porfolios. Depreciation on these systems will commence when the specific system is implemented.

On September 30, 2003, the bank entered into a lease for approximately 102,500 square feet of office space to house its headquarters facility. The lease was effective September 30, 2003, and its term is from September 1, 2003, to August 31, 2013. Under the terms of the lease, the bank was obligated to pay base rental or its share of basic costs during the first 12 months of the lease. Thereafter, the bank will pay annual base rental ranging from $11 per square foot in the second year to $19 per square foot in the tenth year. The bank moved to the new facilities during the second quarter of 2004. Annual lease expenses for the new facility were $2.7 million, $2.9 million and $2.5 million for 2008, 2007 and 2006, respectively.

Following is a schedule of the minimum lease payments remaining on the lease:

	Minimum Lease Payments
2009	$ 1,674
2010	1,776
2011	1,879
2012	1,947
2013	1,297
Total minimum lease payments	$ 8,573

Note 6 — Other Assets and Other Liabilities

Other assets comprised the following at December 31:

	2008	2007	2006
Fair value of derivatives	**$ 31,439**	$ 7,034	$ 1,758
Accounts receivable	**17,414**	8,928	3,551
Investment in other System bank	**10,742**	4,333	2,362
Unamortized debt issue costs	**10,680**	9,628	7,318
Farmer Mac preferred stock	**7,000**	—	—
Other, net	**3,999**	3,320	3,596
Total	**$ 81,274**	$ 33,243	$ 18,585

Other liabilities comprised the following at December 31:

	2008	2007	2006
Accounts payable	**$ 27,308**	$ 25,258	$ 3,373
Patronage payable	**9,994**	7,802	5,551
Obligation for non-pension postretirement benefits	**7,132**	6,472	9,773
FCSIC premium payable	**5,968**	3,800	2,548
Supplemental pension	**5,219**	8,644	3,701
Mortgage life additional reserve	**3,318**	2,935	2,049
Fair value of derivatives	**3,074**	178	3,459
Accrued building lease payable	**1,697**	1,727	1,619
Other, net	**3,197**	1,158	2,133
Total	**$ 66,907**	$ 57,974	$ 34,206

Note 7 — Bonds and Notes

Systemwide Debt Securities:

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide debt securities issued by the banks through the Funding Corporation. Certain conditions must be met before the bank can participate in the issuance of Systemwide debt securities. The bank is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable as a condition for participation in the issuance of Systemwide debt. This requirement does not provide holders of Systemwide debt securities, or bank and other bonds, with a security interest in any assets of the banks. In general, each bank determines its participation in each issue of Systemwide debt securities based on its funding and operating requirements, subject to the availability of eligible assets as described above and subject to Funding Corporation determinations and FCA approval. At December 31, 2008, the bank had such specified eligible assets totaling $14.6 billion and obligations and accrued interest payable totaling $13.9 billion, resulting in excess eligible assets of $770.6 million.

The System banks and the Funding Corporation have entered into the Market Access Agreement (MAA), which established criteria and procedures for the banks to provide certain information to the Funding Corporation and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. At December 31, 2008, the bank was, and currently remains, in compliance with the conditions and requirements of the System banks' and the Funding Corporation's MAA.

Each issuance of Systemwide debt securities ranks equally, in accordance with the FCA regulations, with other unsecured Systemwide debt securities. Systemwide debt securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide debt securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The bank's participation in Systemwide debt securities at December 31, 2008, follows *(dollars in millions)*:

	Systemwide							
	Bonds		Medium-Term Notes		Discount Notes		Total	
Year of Maturity	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
2009	$ 3,444.4	2.71%	$ —	—%	$ 2,466.7	1.37%	$ 5,911.1	2.15%
2010	1,713.6	3.85	—	—	—	—	1,713.6	3.85
2011	1,391.3	3.73	—	—	—	—	1,391.3	3.73
2012	714.9	4.29	—	—	—	—	714.9	4.29
2013	1,393.5	4.28	—	—	—	—	1,393.5	4.28
Subsequent years	2,677.8	5.22	—	—	—	—	2,677.8	5.22
Total	$ 11,335.5	3.89%	$ —	—%	$ 2,466.7	1.37%	$ 13,802.2	3.44%

In the preceding table, the weighted average effective rate reflects the effects of interest rate swaps used to manage the interest rate risk on the bonds and notes issued by the bank. The bank's interest rate swap strategy is discussed more fully in Note 2, "Summary of Significant Accounting Policies" and Note 15, "Derivative Instruments and Hedging Activity."

Systemwide bonds, medium-term notes, master notes, discount notes (Systemwide debt securities) and bank bonds are the joint and several obligations of all System banks. Discount notes are issued with maturities ranging from one to 365 days. The average maturity of discount notes at December 31, 2008, was 107 days.

The bank's Systemwide debt includes callable debt, consisting of the following at December 31, 2008 *(dollars in thousands)*:

Year of Maturity	Amount	Range of First Call Dates
2009	$ 290,000	1/1/2009-2/17/2009
2010	397,000	1/22/2009-10/6/2009
2011	855,000	1/1/2009-11/10/2009
2012	495,000	1/12/2009-12/27/2010
2013	1,228,000	1/1/2009-11/4/2010
Subsequent years	1,840,000	1/1/2009-11/7/2011
Total	$ 5,105,000	1/1/2009-11/7/2011

Callable debt may be called on the first call date and, generally, every day thereafter with seven days' notice. Expenses associated with the exercise of call options on debt issuances are included in interest expense.

As described in Note 1, "Organization and Operations," the Insurance Fund is available to ensure the timely payment of principal and interest on bank bonds and Systemwide debt securities (insured debt) of insured System banks to the extent net assets are available in the Insurance Fund. All other liabilities in the financial statements are uninsured.

Subordinated Debt:

In September 2008, the bank issued $50 million of 8.406 percent unsecured subordinated notes due in 2018, generating proceeds of $49.4 million. The proceeds were used to increase regulatory permanent capital and total surplus pursuant to Farm Credit Administration regulations and for general corporate purposes. This debt is unsecured and subordinate to all other categories of creditors, including general creditors, and senior to all classes of shareholders. Interest is payable semi-annually on March 15 and September 15. Interest will be deferred if, as of the fifth business day prior to an interest payment date of the debt, any applicable minimum regulatory capital ratios are not satisfied. A deferral period may not last for more than five consecutive years or beyond the maturity date of the subordinated debt. During such a period, we may not declare or pay any dividends or patronage refunds, among certain other restrictions, until interest payments are resumed and all deferred interest has been paid. The subordinated debt is not considered Systemwide debt and is not guaranteed by the Farm Credit System or any banks in the System. Payments on the subordinated notes are not insured by the Farm Credit Insurance Fund. In accordance with FCA's approval of the bank's subordinated debt offering, the bank's minimum net collateral ratio for all regulatory purposes while any subordinated debt is outstanding will be 104 percent, instead of the 103 percent stated by regulation.

Other:

The bank maintains a $150.0 million commercial bank committed line of credit to support possible general short-term credit needs.

Note 8 — Shareholders' Equity

Descriptions of the bank's equities, capitalization requirements, and regulatory capitalization requirements and restrictions are provided below.

A. Description of Bank Equities:

On November 7, 2003, the bank issued 100,000 shares of $1,000 cumulative perpetual preferred stock for net proceeds of $98,644, after expenses of $1,356 associated with the offering. The dividend rate is 7.561 percent, payable semi-annually to December 15, 2013, after which dividends are payable quarterly at a rate equal to 3-month London Interbank Offered Rate (LIBOR) plus 445.75 basis points. On September 26, 2005, the bank issued an additional 100,000 shares of cumulative perpetual preferred stock with the same terms. For regulatory purposes, the preferred stock is treated as equity, and is not mandatorily redeemable. Dividends on preferred stock are recorded as declared. The preferred stock ranks, as to dividends and other distributions (including patronage) upon liquidation, dissolution or winding up, prior to all other classes and series of equity securities of the bank. In 2008, preferred stock dividends of $15,122 were declared and paid.

In August 2008, Moody's Investors Service upgraded the bank's issuer rating to Aa2 from the Aa3 rating it had issued in July 2008. In addition, the bank's A2 preferred stock rating was affirmed and the bank received an A1 subordinated debt rating. In June 2008, Fitch Ratings, Ltd. issued an AA-long-term issuer default rating with a stable rating outlook and assigned an A rating to the bank's preferred stock.

According to the bank's bylaws, the minimum and maximum stock investments that the bank may require of the ACAs and FLCAs are 2 percent (or one thousand dollars, whichever is greater) and 5 percent, respectively, of each association's average borrowings from the bank. The investments in the bank are required to be in the form of Class A voting common stock (with a par value of $5 per share) and allocated retained earnings. The current investment required of the associations is 2 percent of their average borrowings from the bank. There were 45,044 shares, 39,378 shares and 31,912 shares of Class A voting common stock issued and outstanding at December 31, 2008, 2007 and 2006, respectively.

The bank requires OFIs to make cash purchases of Class A nonvoting common stock (with a par value of $5 per share) in the bank based on a minimum and maximum of 2 percent (or one thousand dollars, whichever is greater) and 5 percent, respectively, of the OFIs' average borrowings from the bank. The bank has a first lien on these equities for the repayment of any indebtedness to the bank. There were 399 shares, 395 shares and 373 shares of Class A nonvoting common stock issued and outstanding at December 31, 2008, 2007 and 2006, respectively.

Allocated retained earnings of $6,114 at December 31, 2008, consisted of $834 of patronage refunds allocated to certain PCAs, and $5,280 allocated for the payment of patronage on loans participated with another System bank.

Allocated retained earnings of $5,196 at December 31, 2007, consisted of $1,702 of patronage refunds allocated to certain PCAs, and $3,494 allocated for the payment of patronage on loans participated with another System bank.

Allocated retained earnings of $6,194 at December 31, 2006, consisted of $4,286 of patronage refunds allocated to certain PCAs, and $1,908 allocated for the payment of patronage on loans participated with another System bank.

At December 31, the bank's equities included the following:

	2008	2007	2006
Class A voting common stock – Associations	**$ 225,218**	$ 196,888	$ 159,558
Class A nonvoting common stock – Other Financing Institutions	**1,994**	1,976	1,863
Total common stock	**227,212**	198,864	161,421
Preferred stock	**200,000**	200,000	200,000
Allocated retained earnings			
Associations	**834**	1,702	4,286
Other entities	**5,280**	3,494	1,908
Total allocated retained earnings	**6,114**	5,196	6,194
Total capital stock and allocated retained earnings	**$ 433,326**	$ 404,060	$ 367,615

Patronage may be paid to the holders of Class A voting common stock and allocated retained earnings of the bank, as the board of directors may determine by resolution, subject to the capitalization requirements defined by the FCA. During 2008, $51,618 in cash patronages was declared to district associations, OFIs and other entities, compared to $46,174 in 2007 and $37,043 in 2006.

B. Regulatory Capitalization Requirements and Restrictions:

FCA's capital adequacy regulations require the bank to achieve and maintain, at minimum, permanent capital of 7 percent of risk-adjusted assets and off-balance-sheet commitments. The Farm Credit Act has defined permanent capital to include all capital except stock and other equities that may be retired upon the repayment of the holder's loan or otherwise at the option of the holder, or is otherwise not at risk. Risk-adjusted assets have been defined by regulations as the balance sheet assets and off-balance-sheet commitments adjusted by various percentages ranging from 0 to 100 percent, depending on the level of risk inherent in the various types of assets. The bank is prohibited from reducing permanent capital by retiring stock or by making certain other distributions to stockholders unless the minimum permanent capital standard is met.

The bank is required by FCA regulations to achieve and maintain net collateral of at least 103 percent of total liabilities. However, the issuance of subordinated debt resulted in FCA requiring the net collateral to be 104 percent of total liabilities while any subordinated debt is outstanding. Net collateral consists of loans, real or personal property acquired in connection with loans, marketable investments, cash and cash equivalents.

The following table reflects the bank's capital ratios at December 31:

	2008	2007	2006	Regulatory Minimum
Permanent capital ratio	**14.03%**	13.43%	13.67%	7.00%
Total surplus ratio	**11.25**	11.15	11.61	7.00
Core surplus ratio	**6.40**	6.70	6.93	3.50
Collateral ratio	**105.40**	105.18	105.35	103.00

C. Accumulated Other Comprehensive Loss:

Accumulated other comprehensive loss was comprised of the following components at December 31:

	2008	2007	2006
Unrealized losses on investments available-for-sale, net	**$ 21,029**	$ 4,957	$ 21,470
Supplemental pension and other postretirement benefit plans	**1,681**	747	—
Unrealized losses (gains) on cash flow hedge derivatives, net	**3,073**	(1,047)	—
Total	**$ 25,783**	$ 4,657	$ 21,470

Note 9 — Employee Benefit Plans

Employees of the bank participate in either the district's defined benefit retirement plan (DB plan) or in a non-elective defined contribution feature (DC plan) within the Farm Credit Benefits Alliance 401(k) plan. In addition, all employees are eligible to participate in the Farm Credit Benefits Alliance 401(k) plan.

The structure of the district's DB plan is characterized as multi-employer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (bank and associations). No portion of any surplus assets is available to any participating employer. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon combination only. The bank records current contributions to the DB plan as an expense in the current year.

The DB plan is noncontributory and benefits are based on salary and years of service. The "projected unit credit" actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. Additionally, certain qualified individuals in the bank may participate in a separate, nonqualified defined benefit supplemental pension plan. The bank accrues the cost and liability of the supplemental pension plan as incurred, and not as contributions are required. Actuarial information regarding the DB pension plan accumulated benefit obligation and plan asset is calculated for the district as a whole and is presented in the district's Annual Report to Stockholders. The actuarial present value of vested and nonvested accumulated benefit obligation exceeded the net assets of the DB plan as of December 31, 2008. Actuarial information regarding the bank's nonqualified supplemental pension plan's benefit obligations and funded status are disclosed in the following tables.

Participants in the DC plan generally include employees who elected to transfer from the DB plan prior to January 1, 1996, and all employees hired on or after January 1, 1996. Participants in the non-elective pension feature of the DC plan direct the placement of their employers' contributions (5.0 percent of eligible compensation during 2008) made on their behalf into various investment alternatives.

The district also participates in the Farm Credit Benefits Alliance 401(k) plan, which offers a pre-tax and after-tax compensation deferral feature. Employers match 100 percent of employee contributions for the first 3 percent of eligible compensation and then match 50 percent of employee contributions on the next 2 percent of eligible compensation, for a maximum employer contribution of 4 percent of eligible compensation. Additionally, certain employees in the bank that are not eligible for participation in the nonqualified defined benefit supplemental pension plan are eligible to participate in a separate nonqualified supplemental 401(k) plan.

The following table presents the bank's pension benefit expenses for the years ended:

	2008	2007	2006
District DB plan	**$ 2,295**	$ 929	$ 1,466
Supplemental DB plan	**4,525**	1,457	872
DC plan	**634**	564	406
401(k) plan	**619**	558	449
Supplemental 401(k) plan	**47**	—	—
Total	**$ 8,120**	$ 3,508	$ 3,193

The DB plan's investments were significantly impacted by the effects of declines in the general economy and global financial markets during 2008. As a result, future contributions are expected to increase significantly in 2009, and future market conditions and their effect on the plan's assets may continue to have a significant effect on future funding requirements.

In addition to pension benefits, the bank provides certain health care 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. Bank employees hired after January 1, 2004, will be eligible for retiree medical benefits for themselves and their spouses at their expense with no company subsidy.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007. SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, 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 bank decreased retained earnings $406, and increased the supplemental pension and other postretirement benefit liabilities by $406.

The following tables reflect the benefit obligation, cost, funded status and actuarial assumptions for the bank's supplemental pension plan and other postretirement benefits:

	Supplemental Pension Benefits			Other Postretirement Benefits		
	2008	2007	2006	**2008**	2007	2006
Accumulated benefit obligation, end of year	**$ 2,801**	$ 4,676	$ 3,701			
Change in projected benefit obligation						
Benefit obligation, beginning of year	**$ 8,644**	$ 7,288	$ 3,407	**$ 6,547**	$ 6,580	$ 7,374
Service cost	**508**	368	215	**210**	191	220
Interest cost	**682**	427	175	**517**	384	378
Plan participants' contributions	**0**	0	0	**171**	131	124
Plan amendments	**0**	0	3,006	**0**	0	(55)
Settlements	**(458)**	0	0	**0**	0	0
Special termination benefits	**0**	0	0	**0**	0	0
Actuarial loss (gain)	**4,380**	759	485	**298**	(248)	(1,029)
Benefits paid	**(8,537)**	(198)	0	**(611)**	(491)	(432)
Projected benefit obligation, end of year	**$ 5,219**	$ 8,644	$ 7,288	**$ 7,132**	$ 6,547	$ 6,580
Change in plan assets						
Plan assets at fair value, beginning of year	**$ 0**	$ 0	$ 0	**$ 0**	$ 0	$ 0
Actual return on plan assets	**0**	0	0	**0**	0	0
Company contributions	**8,537**	198	0	**440**	360	310
Plan participants' contributions	**0**	0	0	**171**	131	124
Benefits paid	**(8,537)**	(198)	0	**(611)**	(491)	(434)
Plan assets at fair value, end of year	**$ 0**	$ 0	$ 0	**$ 0**	$ 0	$ 0
Reconciliation of funded status						
Unfunded status	**$ (5,219)**	$ (8,644)	$ (7,288)	**$ (7,132)**	$ (6,547)	$ (6,580)
Unrecognized prior service cost	**0**	N/A	3,314	**0**	N/A	(2,927)
Unrecognized net loss (gain)	**0**	N/A	509	**0**	N/A	(343)
Contributions between measurement date and fiscal year end	**0**	0	0	**0**	75	77
Net benefit liability at end of year	**$ (5,219)**	$ (8,644)	$ (3,465)	**$ (7,132)**	$ (6,472)	$ (9,773)
Amounts recognized consist of:						
Accrued liability	**$ 0**	$ 0	$ (3,465)	**$ 0**	$ 0	$ (9,773)
Minimum pension liability adjustment	**0**	0	(236)	**0**	0	0
Intangible asset	**0**	0	236	**0**	0	0
Deferred income tax assets	**0**	0	0	**0**	0	0
Net benefit liability at end of year	**(5,219)**	(8,644)	0	**(7,132)**	(6,472)	0
Accumulated other comprehensive loss (income)	**4,168**	3,921	0	**(2,487)**	(3,174)	0
Amounts recognized in accumulated other comprehensive income						
Additional minimum pension liability adjustment	**$ 0**	$ 0	N/A	**$ 0**	$ 0	N/A
Net actuarial loss (gain)	**1,959**	1,269	N/A	**(282)**	(587)	N/A
Prior service cost (credit)	**2,209**	2,652	N/A	**(2,205)**	(2,587)	N/A
Total	**$ 4,168**	$ 3,921	$ 0	**$ (2,487)**	$ (3,174)	$ 0
Disclosure Information Under FASB Statement 158	**Fiscal 2008**	Fiscal 2007	Fiscal 2006	**Fiscal 2008**	Fiscal 2007	Fiscal 2006
Net periodic benefit cost						
Service cost	**$ 406**	$ 368	$ 215	**$ 168**	$ 191	$ 220
Interest cost	**546**	427	175	**414**	384	378
Expected return on plan assets	**0**	0	6	**0**	0	0
Amortization of:	**0**	0	0		0	0
Transition obligation (asset)	**0**	0	0	**0**	0	0
Prior service cost	**354**	662	476	**(306)**	(340)	(339)
Net actuarial loss	**51**	0	0	**(5)**	(5)	(2)
Net periodic benefit cost	**$ 1,357**	$ 1,457	$ 872	**$ 271**	$ 230	$257
Curtailment expense (income)	**0**	0	0	**0**	0	0
Settlement expense	**3,168**	0	0	**0**	0	0
Special termination benefits	**0**	0	0	**0**	0	0
Total benefit cost	**$ 4,525**	$ 1,457	$ 872	**$ 271**	$ 230	$257
Adjustment to retained earnings for 2008 due to change in measurement date	**$ 339**			**$ 67**		
Other changes to plan assets and projected benefit obligations recognized in other comprehensive income						
Net actuarial loss (gain)	**$ 3,922**	N/A	N/A	**$ 298**	N/A	N/A
Amortization of net actuarial loss (gain)	**(63)**	N/A	N/A	**6**	N/A	N/A
Settlement expense	**(3,168)**	N/A	N/A	**0**	N/A	N/A
Prior service costs	**0**	N/A	N/A	**0**	N/A	N/A
Amortization of prior service costs	**(443)**			**382**		
Termination recognition of prior service costs	**0**	N/A	N/A	**0**	N/A	N/A
Net change	**$ 248**	N/A	N/A	**$ 686**	N/A	N/A
AOCI amounts expected to be amortized in 2009						
Prior service cost (credit)	**$ 354**			**$ (300)**		
Net actuarial loss (gain)	**195**			**0**		
Total	**$ 549**			**$ (300)**		

Weighted-average assumptions used to determine benefit obligation as of December 31						
Measurement date	**12/31/2008**	9/30/2007	9/30/2006	**12/31/2008**	9/30/2007	9/30/2006
Discount rate	**6.30%**	6.50%	6.00%	**6.30%**	6.50%	6.00%
Rate of compensation increase	**7% in 2009 down to 4% in 2012**	8% in 2008 down to 4% in 2012	9% in 2007 down to 4% in 2012			
Health care cost trend rate assumed for next year (pre/post-65)-medical				**8.5%/6.25%**	8.5%/6.5%	9.0%/6.75%
Health care cost trend rate assumed for next year (pre/post-65)-prescriptions				**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
Weighted-average assumptions used to determine net periodic cost for year ended December 31						
Measurement date	**9/30/2007**	9/30/2006	9/30/2005	**9/30/2007**	9/30/2006	9/30/2005
Discount rate	**6.50%**	6.00%	5.25%	**6.50%**	6.00%	5.25%
Expected return on plan assets	**8.00%**	N/A	N/A	**N/A**	N/A	N/A
Rate of compensation increase	**8% in 2008 down to 4% in 2012**	9% in 2007 down to 4% in 2012	4.50%			
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 (pre/post-65)-prescriptions				**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
Effect of Change in Assumed Heath Care Cost Trend Rates						
Effect on total service cost and interest cost components						
One-percentage point increase				$ 118		
One-percentage point decrease				(94)		
Effect on year-end postretirement benefit obligation						
One-percentage point increase				$ 1,140		
One-percentage point decrease				(928)		
Expected Future Cash Flow Information						
Expected Benefit Payments						
Fiscal 2009	$ 463			$ 1,293		
Fiscal 2010	671			1,453		
Fiscal 2011	558			1,590		
Fiscal 2012	1,669			1,713		
Fiscal 2013	472			1,881		
Fiscal 2014 - 2018	2,405			11,460		
Expected Contributions						
Fiscal 2009	$ 463			$ 1,293		

The expected long-term rate of return assumption is determined independently for each defined benefit pension plan and for each other postretirement benefit plan. Generally, plan trustees use historical return information to establish a best-estimate range for each asset class in which the plans would be invested. Plan trustees select the most appropriate rate for each plan from the best-estimate range, taking into consideration the duration of plan benefit liabilities and plan sponsor investment policies.

Note 10 — Related Party Transactions

As discussed in Note 1, "Organization and Operations," the bank lends funds to the district associations to fund their loan portfolios. Interest income recognized on direct notes receivable from district associations was $394,059, $452,775 and $395,822 for 2008, 2007 and 2006, respectively. Further disclosure regarding these related party transactions is found in Note 4, "Loans and Allowances for Loan Losses," and Note 8, "Shareholders' Equity."

In addition to providing loan funds to district associations, the bank also provides banking and support services to them, such as accounting, information systems, marketing and other services. Income derived by the bank from these activities was $9,435, $8,918 and $8,856 for 2008, 2007 and 2006, respectively, and was included in the bank's noninterest income.

The bank had no loans to directors or officers during 2008, 2007 or 2006.

Note 11 — Commitments and Contingencies

In the normal course of business, the bank has various outstanding commitments and contingent liabilities as discussed elsewhere in these notes.

The bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the bank is jointly and severally liable for the consolidated Systemwide bonds and notes of other System banks. The total bank and consolidated Systemwide debt obligations of the System at December 31, 2008, were approximately $178.4 billion.

Other actions are pending against the bank in which claims for monetary damages are asserted. Upon the basis of current information, management and legal counsel are of the opinion that the ultimate liability, if any, resulting from a lawsuit and other pending actions will not be material in relation to the financial position, results of operations or cash flows of the bank.

Note 12 — Financial Instruments With Off-Balance-Sheet Risk

The bank may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2008, $1.765 billion of commitments to extend credit and $135.8 million of standby letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the balance sheet until funded or drawn upon.

The bank also participates in standby letters of credit to satisfy the financing needs of their borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Standby letters of credit are recorded, at fair value, on the balance sheet by the bank. At December 31, 2008, $135.8 million of standby letters of credit with a fair value of $1.9 million was included in other liabilities. Outstanding standby letters of credit have expiration dates ranging from 2009 to 2013. The maximum potential amount of future payments the bank is required to make under the guarantees is $135.8 million.

The credit risk involved in issuing commitments and letters of credit is essentially the same as that involved in extending loans to customers, and the same credit policies are applied by management. In the event of funding, the credit risk amounts are equal to the contract amounts, assuming that counterparties 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 counterparty.

Note 13 — Fair Value Measurements

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. See Note 2, "Summary of Significant Accounting Policies," for additional information.

Assets and liabilities measured at fair value on a recurring basis at December 31, 2008 for each of the fair value hierarchy values are summarized below:

Fair Value Measurement at December 31, 2008				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Federal funds and securities purchased under resale agreements	**$ 176,698**	$ —	$ 176,698	$ —
Investments available-for-sale	**2,977,928**	—	2,877,936	99,992
Derivative assets	**31,439**	—	31,439	—
Assets held in non-qualified benefit trusts	**90**	90	—	—
Total assets	**$ 3,186,155**	$ 90	$ 3,086,073	$ 99,992
Liabilities:				
Derivative liabilities	**$ 3,074**	$ —	$ 3,074	$ —
Standby letters of credit	**1,901**	—	1,901	—
Collateral liabilities	**1,080**	—	1,080	—
Total liabilities	**$ 6,055**	$ —	$ 6,055	$ —

The table below represents a reconciliation of all Level 3 assets and liabilities measured at fair value on a recurring basis for the year ended December 31, 2008:

Level 3 Assets and Liabilities	
	Investment Securities
Balance at January 1, 2008	$ 273,231
Net losses included in other comprehensive income	864
Purchases, issuances and settlements	(112,973)
Net transfers from Level 3	(61,130)
Balance at December 31, 2008	$ 99,992
The amount of gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at December 31, 2008	$ 2,238

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2008 for each of the fair value hierarchy values are summarized below:

Fair Value Measurement at December 31, 2008				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans	**$ 28,640**	$ —	$ —	$ 28,640
Total assets	**$ 28,640**	$ —	$ —	$ 28,640

VALUATION TECHNIQUES

As more fully discussed in Note 2, "Summary of Significant Accounting Policies," SFAS No. 157 establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used by the bank for assets and liabilities:

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. Among other securities, this would include certain mortgage-backed securities and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include commercial paper at December 31, 2008. At January 1, 2008, Level 3 securities included commercial paper and certain asset-backed securities.

Assets Held in Non-Qualified Benefits Trusts

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments in mutual funds.

Derivatives

Exchange-traded derivatives valued using quoted prices would be classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the majority of the derivative positions are valued using internally developed models that use as their basis readily observable market parameters and are classified within Level 2 of the valuation hierarchy. Such derivatives include basic interest rate swaps and cash flow derivatives.

Loans

On a nonrecurring basis, specific allowances for loan losses on certain collateral-dependent impaired loans have been recorded to effectively measure the loans, net of their specific allowances, at the fair value of the collateral on which repayment is deemed to be dependent. At December 31, 2008, impaired loans with a fair value of $28,640 were included in loans.

Note 14 — Disclosure About the Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the bank's financial instruments at December 31, 2008, 2007 and 2006.

The estimated fair values of the bank's financial instruments follow:

	December 31, 2008		December 31, 2007		December 31, 2006	
Financial assets	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash, federal funds sold, securities purchased under resale agreements and investment securities	**$ 3,218,259**	**$ 3,219,362**	$ 2,553,101	$ 2,553,101	$ 2,775,636	$ 2,775,636
Loans	**11,403,113**	**11,612,380**	10,865,991	10,799,211	10,055,428	9,935,881
Allowance for loan losses	**(12,549)**	**—**	(1,065)	—	(142)	—
Loans, net	**11,390,564**	**11,612,380**	10,864,926	10,799,211	10,055,286	9,935,881
Derivative assets	**31,439**	**31,439**	7,034	7,034	1,758	1,758
Financial liabilities						
Bonds and notes	**13,805,279**	**14,087,310**	12,624,193	12,739,340	12,124,242	12,121,813
Fair value adjustment of derivatives	**(3,074)**	**(3,074)**	(178)	(178)	(3,459)	(3,459)
Total bonds and notes, net	**13,802,205**	**14,084,236**	12,624,015	12,739,162	12,120,783	12,118,354
Subordinated debt	**50,000**	**56,168**	—	—	—	—
Derivative liabilities	**3,074**	**3,074**	178	178	3,459	3,459

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

A. Cash, Federal Funds Sold, and Securities Purchased Under Resale Agreements:

The carrying value is a reasonable estimate of fair value.

B. Investment Securities:

Investment securities: If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, the fair value is determined as described in Note 13, "Fair Value Measurements."

C. Loans:

Because no active market exists for the bank's loans, fair value is estimated by discounting the expected future cash flows using the bank's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the bank's loan rates as well as 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 a nonaccrual status which 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.

D. Bonds and Notes:

Systemwide bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of new issues of Systemwide bonds with similar-maturity terms.

E. Subordinated Debt:

As discussed in Note 7, "Bonds and Notes," the bank issued subordinated debt in 2008. The fair value of these obligations is determined by discounting expected future cash flows based on the Treasury yield curve.

F. Derivative Assets and Liabilities:

The fair value of derivative financial instruments is the estimated amount that a bank would receive or pay to replace the instruments at the reporting date, considering the current interest rate environment and the current creditworthiness of the counterparties. Where such quoted market prices do not exist, these values are generally provided by sources outside the respective bank or by internal market valuation models.

G. Commitments to Extend Credit:

Fees on commitments to extend credit are not normally assessed; hence, there is no fair value to be assigned to these commitments until they are funded.

Note 15 — Derivative Instruments and Hedging Activity

The bank maintains an overall interest rate risk-management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet liabilities so that the net interest margin is not adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the bank's gains or losses on the derivative instruments that are linked to these hedged liabilities. Another result of interest rate fluctuations is that the interest expense of hedged variable-rate liabilities will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the bank's gains and losses on the derivative instruments that are linked to these hedged liabilities. The bank considers its strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The bank enters into derivatives, particularly fair value interest rate swaps and cash flow interest rate swaps, primarily to lower interest rate risk. Fair value hedges allow the bank to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the bank if floating-rate borrowings were made directly. Under fair value hedge arrangements, the bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating-rate index. At December 31, 2008, the bank had four fair value hedges with a total notional amount of $350 million.

The bank's interest-earning assets (principally loans and investments) tend to be medium-term floating-rate instruments, while the related interest-bearing liabilities tend to be short- or medium-term fixed-rate obligations. Given this asset-liability mismatch, fair value hedges in which the bank pays the floating rate and receives the fixed rate (receive fixed swaps) are used to reduce the impact of market fluctuations on the bank's net interest income.

At December 31, 2008, the bank had four cash flow hedges, with a total notional amount of $450 million, which hedge the exposure to variability in expected future cash flows.

By using derivative instruments, the bank exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the bank's credit risk will equal the fair value gain of the derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the bank, thus creating a repayment risk for the bank. When the fair value of the derivative contract is negative, the bank owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the bank maintains collateral agreements to limit exposure to agreed upon thresholds; the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing of, and levels of exposure to, individual counterparties. The bank typically enters into master agreements that contain netting provisions. These provisions allow the bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. At December 31, 2008, the bank had credit exposure totaling $32.1 million, net of $1.1 million in collateral held, with three counterparties. The bank does not anticipate nonperformance by these counterparties.

The credit exposure represents the exposure to credit loss on derivative instruments, which is estimated by calculating the cost, on a present value basis, to replace all outstanding derivative contracts in a gain position.

The table below presents the credit ratings of counterparties to whom the bank has credit exposure:

($ in millions)	Remaining Years to Maturity: Less Than 1 Year	Remaining Years to Maturity: Over 5 Years	Total	Maturity Distribution Netting	Exposure	Collateral Held	Exposure Net of Collateral
Moody's Credit Rating							
Aaa	$ (1.4)	$ 16.7	$ 15.3	$ —	$ 15.3	$ —	$ 15.3
Aaa	0.6	16.7	17.3	$ —	17.3	1.1	16.2
Aa2	0.6	—	0.6	—	0.6	—	0.6

The bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the ALCO's oversight of the bank's asset/liability and treasury functions. The ALCO is responsible for approving hedging strategies that are developed through its analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the bank's overall interest rate risk-management strategies.

The table below provides information about derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. The debt information below presents the principal cash flows and related weighted average interest rates by expected maturity dates. The derivative information below represents the notional amounts and weighted average interest rates by expected maturity dates.

December 31, 2008	Maturities of 2008 Derivative Products and Other Financial Instruments							
($ in millions)	2009	2010	2011	2012	2013	Subsequent Years	Total	Fair Value
Total Systemwide debt obligations:								
Fixed rate	$ 4,436	$ 1,614	$ 1,391	$ 715	$ 1,393	$ 2,678	$ 12,227	$ 12,509
Weighted average interest rate	2.60%	3.98%	3.73%	4.29%	4.28%	5.22%	3.77%	
Variable rate	$ 1,475	$ 100	$ —	$ —	$ —	$ —	$ 1,575	$ 1,575
Weighted average interest rate	2.52%	1.83%	—	—	—	—	2.48%	
Total Systemwide debt obligations	$ 5,911	$ 1,714	$ 1,391	$ 715	$ 1,393	$ 2,678	$ 13,802	$ 14,084
Weighted average interest rate	2.15%	3.85	3.73%	4.29%	4.28%	5.22%	3.44%	
Derivative instruments:								
Receive fixed swaps								
Notional value	$ 200	$ —	$ —	$ —	$ —	$ 150	$ 350	$ 31
Weighted average receive rate	2.60%	—	—	—	—	4.95%	3.61%	
Weighted average pay rate	0.92%	—	—	—	—	0.83%	0.88%	
Pay fixed swaps								
Notional value	$ 450	$ —	$ —	$ —	$ —	$ —	$ 450	$ (3)
Weighted average receive rate	1.90%	—	—	—	—	—	1.90%	
Weighted average pay rate	3.91%	—	—	—	—	—	3.91%	

Note 16 — Selected Quarterly Financial Information (Unaudited)

Quarterly results of operations are shown below for the years ended December 31:

	2008				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	**$ 28,080**	**$ 29,386**	**$ 30,375**	**$ 31,555**	**$ 119,396**
Provision for loan losses	**2,153**	**2,594**	**5,998**	**9,784**	**20,529**
Noninterest expense, net	**4,908**	**4,594**	**5,229**	**7,403**	**22,134**
Net income	**$ 21,019**	**$ 22,198**	**$ 19,148**	**$ 14,368**	**$ 76,733**

	2007				
	First	Second	Third	Fourth	Total
Net interest income	$ 25,009	$ 25,005	$ 24,785	$ 24,766	$ 99,565
Provision (negative provision) for loan losses	—	400	(282)	925	1,043
Noninterest expense, net	7,486	6,376	6,227	4,429	24,518
Net income	$ 17,523	$ 18,229	$ 18,840	$ 19,412	$ 74,004

	2006				
	First	Second	Third	Fourth	Total
Net interest income	$ 22,446	$ 22,115	$ 22,231	$ 23,549	$ 90,341
Provision for loan losses	—	2,578	—	—	2,578
Noninterest expense, net	6,734	5,594	4,269	6,172	22,769
Net income	$ 15,712	$ 13,943	$ 17,962	$ 17,377	$ 64,994

Note 17 — Combined Association Financial Data (Unaudited)

Condensed financial information for the combined district associations follows. All significant transactions and balances between the associations are eliminated in combination. The multi-employer structure of certain of the district's retirement and benefit plans results in the recording of these plans only in the district's combined financial statements.

	December 31,		
Balance Sheet Data	**2008**	2007	2006
Cash	**$ 43,789**	$ 39,103	$ 46,005
Investment securities	**17,929**	—	—
Loans	**13,468,746**	12,300,861	10,665,377
Less allowance for loan losses	**39,104**	23,430	13,827
Net loans	**13,429,642**	12,277,431	10,651,550
Accrued interest receivable	**173,210**	197,117	176,583
Other property owned, net	**6,495**	1,817	2,020
Other assets	**293,655**	262,802	211,927
Total assets	**$13,964,720**	$12,778,270	$11,088,085
Notes payable	**$11,782,402**	$10,747,261	$ 9,214,287
Other liabilities	**248,596**	252,204	235,617
Total liabilities	**12,030,998**	10,999,465	9,449,904
Capital stock and participation certificates	**64,619**	63,267	60,771
Retained earnings	**1,860,481**	1,705,238	1,577,410
Accumulated other comprehensive income	**8,622**	10,300	—
Total shareholders' equity	**1,933,722**	1,778,805	1,638,181
Total liabilities and shareholders' equity	**$13,964,720**	$12,778,270	$11,088,085

	Year Ended December 31,		
Statement of Income Data	**2008**	2007	2006
Interest income	**$ 849,893**	$ 883,219	$ 724,454
Interest expense	**498,353**	551,113	428,281
Net interest income	**351,540**	332,106	296,173
Provision for loan losses	**32,985**	42,088	6,778
Net interest income after provision for loan losses	**318,555**	290,018	289,395
Noninterest income	**82,520**	74,955	66,257
Other expense	**176,892**	157,070	144,261
Provision for (benefit from) income taxes	**344**	141	(228)
Net income	**$ 223,839**	$ 207,762	$ 211,619

DISCLOSURE INFORMATION AND INDEX

DISCLOSURES REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

Description of Business

The Farm Credit Bank of Texas (FCBT or bank), Agricultural Credit Associations (ACAs) and the Federal Land Credit Associations (FLCAs) of the Tenth Farm Credit District (district) are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrower-shareholders for qualified agricultural purposes in the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. The district's ACA parent associations, which each contain wholly-owned FLCA and Production Credit Association (PCA) subsidiaries, and FLCAs are collectively referred to as associations. A further description of territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations required to be disclosed in this section are incorporated herein by reference to Note 1, "Organization and Operations," to the accompanying financial statements.

The description of significant developments that had or could have a material impact on results of operations or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting business, seasonal characteristics and concentrations of assets, if any, required to be disclosed in this section are incorporated herein by reference to "Management's Discussion and Analysis" of the bank included in this annual report to shareholders.

Directors and Senior Officers

The following represents certain information regarding the district directors and senior officers of the bank as of February 27, 2009:

DIRECTORS

Ralph W. Cortese joined the board in 1995, and his current term expires December 31, 2010. Cortese has served as chairman since 2000. Prior to joining the bank board, Cortese was chairman of the PCA of Eastern New Mexico Board of Directors. Early in his career, he was vice president of Roswell PCA. He is a farmer and rancher from Fort Sumner, New Mexico. In 2001, he joined the American Land Foundation Board. He is a member of the bank's Audit and Compensation committees. In June 2003, he was appointed to the Farmer Mac Board with an appointment which expired in 2008. He is also a member of the Texas Agricultural Cooperative Council board of directors.

Jon M. Garnett began his first term on the board in 1999, and his current term expires December 31, 2010. He served as board vice chairman from 2000 through 2008. Prior to joining the bank board, he was chairman of Panhandle-Plains Land Bank, FLCA Board of Directors. In January 2003, he joined the national Farm Credit Council Board of Directors as a Tenth District representative and is a member of the Farm Credit Council Board of Directors' legislative committee. He is also a member of the bank's Audit Committee and the State Technical Committee for the Natural Resources Conservation Service, and is the chairman of the bank's Compensation Committee. Garnett raises grain and forage crops and runs stocker cattle near Spearman, Texas.

C. Kenneth Andrews began service on the board in 1994, and his current term expired December 31, 2008. He was manager of the former FLBA of Madisonville for 17 years and later served on the board of directors of the FLBA of Bryan. The Madisonville, Texas, rancher was a member of the Tenth District Farm Credit Council and represented the district on the national Farm Credit Council Board of Directors from 1996 to 2005. He also served on the bank's Audit and Compensation committees. Andrews retired from the bank's board upon the expiration of his term.

Joe R. Crawford began his first term on the board in 1998, and his current term expires December 31, 2009. Previously, he was a member of the FLBA of North Alabama Board of Directors. He also served on the Tenth District FLBA Legislative Advisory Committee. Vice chairman of the bank's Audit Committee, Crawford also serves on the bank's Compensation Committee. He is a director on the board and an audit committee member of the Federal Farm Credit Banks Funding Corporation. He is also a member and past president of the Alabama Cattlemen's Association and a member of the National Cattlemen's Beef Association, the Alabama Farm Bureau and the Alabama Farmers Federation. Crawford, who lives near Baileyton, Alabama, has owned and operated a cattle business since 1968.

James F. Dodson joined the board of directors in January 2003, and his current term expired December 31, 2008. Dodson was reelected to the board with his new term expiring December 31, 2011. He is a past chairman of the Texas AgFinance, FCS Board of Directors and a former member of the Tenth Farm Credit District Stockholders' Advisory Committee. He is chairman of the Tenth District Farm Credit Council board and serves on the bank's Audit and Compensation committees. Dodson grows cotton and milo and operates a seed sales business with his family in Robstown, Texas. He is the president of Dodson Farms, Inc. and Dodson Ag, Inc.; the owner of Jimmy Dodson Farms; a partner in Weber Greene, Ltd.; and managing partner in Weber Station LLC. In addition, Dodson serves on the boards of Gulf Coast Cooperative and South Texas Cotton and Grain Association, and holds leadership positions in the National Cotton Council of America and American Cotton Producers.

Elizabeth G. Flores joined the board in August 2006, and her current term expires December 31, 2009. She was mayor of Laredo, Texas, where she resides, from 1998 to June 2006. Previously, she was senior vice president of Laredo National Bank. Flores serves on the boards of the Texas Agricultural Cooperative Council and the TMF Health Quality Institute, and is a graduate of Leadership Texas 1995 and Leadership America 2008. She is a partner with a ranching and real estate limited partnership, E.G. Ranch, Ltd. She is a former member of the Federal Reserve Board Comsumer Advisory Council. Flores also is a member of the bank's Audit and Compensation committees.

William F. Staats joined the board in 1997, and his current term expired December 31, 2008. Staats was reappointed by the board to a new term expiring December 31, 2011. Staats is Louisiana Bankers Association Chair Emeritus of Banking and Professor Emeritus, Department of Finance, at Louisiana State University, where he held the Hermann Moyse Jr. Distinguished Professorship. Previously, he was vice president and corporate secretary of the Federal Reserve Bank of Philadelphia. Staats also serves on the boards of the Money Management International Education Foundation, Money Management International, SevenOaks Capital Associates, LLC and Platinum Healthcare Staffing, Inc. He is a member of the Farm Credit System Audit Committee, is chairman of the bank's Audit Committee, serves on the bank's Compensation Committee, and is the bank's designated financial expert. He is also a member of the Texas Lutheran University board of regents.

Lester Little joined the board in 2009 and his term will expire December 31, 2011. Little fills the director position previously held by C. Kenneth Andrews. Prior to joining the bank board, Little was chairman of Capital Farm Credit Board of Directors and previously served as vice chairman of the Tenth Farm Credit District Stockholders' Advisory Committee. He also was a member of the district's Association Business Advisory Committee. Little is a member of the bank's Audit and Compensation committees. He is from Hallettsville, Texas, and owns and operates a farm, and offers custom-farming services. He is a Farm Bureau member, chairman of the Lavaca Exposition Association and board chairman of the Hallettsville Junior Livestock Show.

Compensation of Directors

Directors of the bank are compensated in cash for service on the bank's board. Compensation for 2008 was paid at the rate of $50,205 per year, payable at $4,183 per month. In addition to days served at board meetings, directors may serve additional days on other official assignments, and under exceptional circumstances where extraordinary time and effort are involved, the board may approve additional compensation, not to exceed 30 percent of the annual maximum allowable by FCA regulations. No additional compensation was approved or paid during 2008. No director received non-cash compensation exceeding $5,000 in 2008. Total cash compensation paid to all directors as a group during 2008 was $351,435. Information for each director for the year ended December 31, 2008, is provided below:

Board Member	Days Served at Board Meetings*	Days Served on Other Official Assignments**	Total Compensation Paid
Ralph W. Cortese	32.0	40.5	$ 50,205
Jon M. Garnett	32.0	33.5	50,205
C. Kenneth Andrews	32.0	12.5	50,205
Joe R. Crawford	29.0	39.0	50,205
James F. Dodson	32.0	37.0	50,205
Elizabeth G. Flores	32.0	22.5	50,205
William F. Staats	32.0	19.5	50,205
			$ 351,435

*Includes travel time, but does not include time required to prepare for board meetings.

**Includes Audit Committee meetings, Compensation Committee meetings, special assignments, training and travel time.

Directors are reimbursed for reasonable travel, subsistence and other related expenses while conducting bank business. The aggregate amount of expenses reimbursed to directors in 2008, 2007 and 2006 totaled $162,118, $149,254 and $123,258, respectively. The increase in expenses in 2008 as compared to the previous year was primarily due to an overall increase in costs for travel related to airlines and fuel as well as an increase in travel expenses associated with the participation by members of the board in meetings held by other System entities. The increase in expenses for 2007 as compared to 2006 was primarily due to the addition of a board member in late 2006. A copy of the bank's travel policy is available to shareholders upon request.

SENIOR OFFICERS

Name and Title	Time in Position	Experience — Past Five Years
Larry R. Doyle, *Chief Executive Officer*	5.5 years	Chief Executive Officer, FCBT Prior to joining FCBT, Executive Vice President and Chief Operating Officer, AgFirst Farm Credit Bank
Thomas W. Hill, *Senior Vice President, Chief Financial Officer, Chief Operations Officer*	14 years 5 years	Senior Vice President, Chief Financial Officer, FCBT
Steven H. Fowlkes, *Senior Vice President, Chief Credit Officer*	11 years 5 years	Senior management and management positions, FCBT
Kyle Pankonien, *Vice President, Corporate Affairs, General Counsel and Corporate Secretary*	1 year	Vice President, Corporate Affairs, Deputy General Counsel, FCBT
William E. Zimmerman, *Senior Vice President, Corporate Affairs, General Counsel and Corporate Secretary*	20 years Retired January 2008	Senior Vice President, Corporate Affairs, General Counsel and Corporate Secretary, FCBT

Compensation Discussion and Analysis – Senior Officers

Overview

The board of directors of the Farm Credit Bank of Texas, through its Compensation Committee, has pursued a compensation philosophy for the bank that promotes leadership in the adoption and administration of a comprehensive compensation program so that:

- Competent senior officers can be attracted, developed and retained for the delivery of performance that will result in the attainment of the bank's strategic business plan;
- Operational activities that produce bank efficiencies and produce financial results that maximize the principles of a cooperative organization will be rewarded;
- Consistent application of compensation programs will link compensation to bank performance and levels of accountability for the achievement of the bank's strategies and programs; and,
- Market-based base salaries, benefits and bonus compensation will position the bank to be a competitive employer in the financial services marketplace.

The Compensation Committee annually reviews the appropriate mix of salaries, benefits and bonus arrangements and approves these programs for senior officers of the bank. With data derived from an independent third-party compensation consultant, the Compensation Committee considers market salary data of competition in the financial services sector to ensure that base salaries and bonus plan structures are in line with market-comparable positions with similarly situated financial institutions. This study provides the basis for actions by the Compensation Committee to approve the compensation level and bonus plan structure of the bank's chief executive officer (CEO) annually, plus review and approve other compensation programs for the other senior officers of the bank. The bank's compensation program encompasses four primary elements: (1) base salary, (2) discretionary bonus compensation, (3) bank-paid retirement benefits and (4) secondary benefits such as an executive physical program, annual leave, bank-paid life insurance and bank-provided vehicles.

Chief Executive Officer (CEO) Compensation Table and Policy

The base salary amount of the CEO was $500,019 for 2008. The amount of the CEO's non-equity discretionary bonus compensation was higher than his base salary amount for 2008, which in essence put more of the CEO's total compensation "at risk" based on the performance of the bank. The Compensation Committee considered the year-end 2008 results of certain financial key performance indicators, such as return on assets, return on equity, collateral ratio, credit quality ratios, growth in total and net assets, net income and level of patronage dividends to shareholders, along with accomplishments of the bank in attaining strategic plan operational objectives as the bases for determining the discretionary bonus for the CEO for 2008. Included in the process for awarding base and bonus compensation for the CEO was the committee's annual appraisal assessment of the CEO's performance in areas such as Farm Credit System and Farm Credit Administration relationships; alliances with other financial institutions; and coordination of bank board, stockholder and association relations.

As discussed in detail below, the Compensation Committee settled the bank's obligations to the CEO with respect to the Farm Credit Bank of Texas Supplemental Pension Plan pursuant to a Compensation Agreement between the bank and the CEO.

The following table summarizes the compensation paid to the CEO of the bank during 2008, 2007 and 2006.

Summary Compensation Table for the CEO

Name of Chief Executive Officer	Year	Salary (a)	Bonus (b)	Annual Change in Pension Value (c)	Deferred/Perquisites (d)	Other (e)	Total
Larry R. Doyle	2008	$500,019	$600,000	<$5,810,710>	$19,229	$8,821,430	$4,129,968
Larry R. Doyle	2007	$440,017	$560,000	$1,884,534	$22,017	N/A	$2,906,568
Larry R. Doyle	2006	$440,017	$440,000	N/A	$20,362	N/A	$900,379

(a) Gross salary for year presented.

(b) Bonus compensation is presented in the year earned, and bonuses are paid within the first 30 days of the subsequent calendar year.

(c) Disclosure of change in pension value reflected only for years 2007 and 2008. "N/A" represents information not available for year 2006. The amounts in column (c) represent the change in the actuarial present value of the accumulated benefit under both defined benefit pension plans (i.e., the Farm Credit Bank of Texas Pension Plan and the Farm Credit Bank of Texas Supplemental Pension Plan) from the pension measurement date used for financial statement reporting purposes with respect to the audited financial statements for the prior completed fiscal year to the pension measurement date used for financial statement reporting purposes with respect to the audited financial statements for the covered fiscal year. The decrease in pension value for 2008 is because the CEO no longer participates in the Farm Credit Bank of Texas Supplemental Pension Plan, under the terms of the Compensation Agreement entered into between the bank and the CEO in November 2008. See the Pension Benefits Table Narrative Disclosure for a more detailed explanation regarding the Compensation Agreement.

(d) Deferred/Perquisites include contributions to a 401(k) plan, automobile benefits, and premiums paid for life insurance.

(e) Other reflects the payment of $8,500,000 made in January 2009 pursuant to the Compensation Agreement between the bank and the CEO. In part, this payment was in exchange for the CEO's agreement to no longer participate in the Farm Credit Bank of Texas Supplemental Pension Plan. The CEO is also eligible for a $4,500,000 payment in January 2010, although that payment will be prorated if his employment terminates prior to January 4, 2010. The prorated amount of $4,500,000 as of December 31, 2008 was $321,430, which was earned in 2008 and is also reflected in Other. See the Pension Benefits Table Narrative Disclosure for a more detailed explanation of the Compensation Agreement and the payments provided thereunder.

Pension Benefits Table for the CEO

The following table presents a summary of the total annual benefit provided from both defined benefit pension plans applicable to the CEO for the year ended December 31, 2008:

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit	Payments During 2008
Larry R. Doyle	Farm Credit Bank of Texas Pension Plan	34.780	$ 880,276	$ 0
	Farm Credit Bank of Texas Supplemental Pension Plan	34.780	$ 0	$ 0

Pension Benefits Table Narrative Disclosure for the CEO

The CEO participates in the Farm Credit Bank of Texas Pension Plan (the "Pension Plan"), which is a qualified defined benefit retirement plan. Through the end of 2008, the CEO also participated in the Farm Credit Bank of Texas Supplemental Pension Plan (the "Supplemental Pension Plan"), which is a nonqualified deferred compensation plan. Compensation, as defined in the Pension Plan, includes wages, incentive compensation and deferrals to the 401(k) and flexible spending account plans, but excludes annual leave or sick leave that may be paid in cash at the time of termination, retirement, or transfer of employment, severance payments, retention bonuses, taxable fringe benefits, and any other payments. Pension Plan benefits are based on the average of monthly eligible compensation over the 60 consecutive months that produce the highest average after 1996 ("FAC60"). The Pension Plan's benefit formula for a Normal Retirement Pension is the sum of (a) 1.65 percent of FAC60 times "Years of Benefit Service" and (b) 0.50 percent of (i) FAC60 in excess of Social Security covered compensation times (ii) "Years of Benefit Service" (not to exceed 35). The CEO's Pension Plan benefit is offset by the CEO's pension benefits from another Farm Credit System institution. The present value of the CEO's accumulated Pension Plan and Supplemental Pension Plan benefits are calculated assuming retirement had occurred at the measurement date used for financial statement reporting purposes with retirement at age 56. The Pension Plan's benefit formula for the Normal Retirement Pension assumes that the CEO is married on the date the annuity begins, that the spouse is exactly 2 years younger than the CEO, and that the benefit is payable in the form of a 50 percent joint and survivor annuity. If any of those assumptions are incorrect, the benefit is recalculated to be the actuarial equivalent benefit. The Supplemental Pension Plan restores benefits under the Pension Plan that are limited or reduced (a) by the imposition of Internal Revenue Code limits, (b) by the exclusion of deferrals to a nonqualified deferred compensation plan from the definition of "Compensation" in the Pension

Plan, and (c) by the commencement of benefits prior to "Normal Retirement Age" for a participant who has satisfied the rule of 85 and is at least age 55. After calculating the amount of Pension Plan benefits that are restored in the Supplemental Pension Plan, that amount is grossed-up for income taxes at a fixed rate. Supplemental Pension Plan benefits are payable 30 days after separation from service as a lump sum amount.

The CEO's earned benefit under the Supplemental Pension Plan was $8,537,622 as of December 2008 and was projected to increase significantly in the coming years based upon his "Years of Benefit Service" and anticipated total compensation during 2009, 2010, 2011 and 2012. Therefore, under a Compensation Agreement between the bank and the CEO that was executed in November 2008, the board approved the settlement of the bank's obligations to the CEO under the Supplemental Pension Plan in order (a) to limit the bank's potential future liability under the Supplemental Pension Plan; (b) to decrease the impact upon the bank and the Supplemental Pension Plan of changes in compensation paid to the CEO, changes in interest rates, and changes in law; (c) to remove uncertainty for the bank and the CEO with respect to the amount of the Supplemental Pension Plan benefit; (d) to agree upon a fixed amount of compensation for the CEO during 2009 and 2010; and (e) to provide incentives for the CEO to remain employed at least through the period involving the development of an important lending systems project. Pursuant to the terms and conditions of the Compensation Agreement, the CEO received the following benefits: (i) a payment of $8,500,000 in January 2009; (ii) deferred compensation in the amount of $4,500,000 which will be paid to the CEO (or his beneficiary in the event of his death) in January 2010, unless the CEO's employment with the bank terminates prior to January 4, 2010, in which case the $4,500,000 payment will be prorated according to a schedule in the Compensation Agreement and paid within 60 days of such termination; (iii) annual base salary of $750,000 for 2009 and 2010. In exchange for those benefits, the Compensation Agreement provides that the CEO will not (1) participate in the Supplemental Pension Plan as of January 1, 2009; (2) actively participate in another nonqualified plan the bank has established; (3) earn any bonuses for performance during 2009 or 2010; and (4) receive the set severance payment of $1,000,000 which was provided under Mr. Doyle's "employment at will" agreement dated February 26, 2003. Although the Compensation Agreement only covers the CEO's compensation through 2010, the board of the bank hopes to retain the CEO for a longer period, due to the current economic conditions. Therefore, the Compensation Agreement further provides that if the CEO remains employed past 2010, he shall be eligible for bonuses for years after 2010 and that base salary for years after 2010 shall be negotiated in late 2010.

The Compensation Agreement is not an employment contract. The deferred compensation provisions of the Compensation Agreement are intended to be an unfunded nonqualified deferred compensation plan for tax purposes, are not intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code, and are intended to be exempt from ERISA as a governmental plan exempted under ERISA § 4(b)(1). The Compensation Agreement was drafted to comply with the provisions of Section 409A of the Internal Revenue Code.

Compensation of Other Senior Officers

The following table summarizes the compensation paid to the five highest paid officers of the bank during 2008, 2007 and 2006. Amounts reflected in the table are presented in the year the compensation is earned.

Summary Compensation Table

		Annual				
Name of Individual or Group	Year	Salary (a)	Bonus (b)	Deferred/Perquisites (c)	Other (d)	Total
Aggregate of five highest paid officers: (excludes Chief Executive Officer)						
5	2008	$ 1,249,615	$ 396,360	$ 126,827	–	$ 1,772,802
5	2007	1,118,743	404,825	115,711	–	1,639,279
5	2006	1,072,241	371,960	105,873	–	1,550,074

(a) Gross salary.
(b) Bonuses paid within the first 30 days of the subsequent calendar year.
(c) Deferred/Perquisites include contributions to 401(k) and defined contribution plans, automobile benefits and premiums paid for life insurance.
(d) Other - no amounts paid in years presented.

Other senior officers of the bank are eligible for deferred compensation plans and can participate in a retention plan, at the discretion and approval of the bank board's Compensation Committee. Amounts paid in 2008 to any senior officer associated with the retention plan are reflected in the salary column in the above table. Senior officers, other than the CEO, participate in a bank discretionary bonus program, whose terms and conditions are detailed in writing as a Success Sharing Plan, with awards annually approved by the board's Compensation Committee. Neither the CEO nor any other senior officer received non-cash compensation exceeding $5,000 in 2008.

Disclosure of the compensation paid during 2008 to any senior officer or officer included in the table is available and will be disclosed to shareholders of the institution and stockholders of the district's associations upon written request.

Senior officers, including the CEO, are reimbursed for reasonable travel, subsistence and other related expenses while conducting bank business. A copy of the bank's travel policy is available to shareholders upon request.

Bank employees can earn compensation above base salary through an annual Success Sharing Plan, which the bank adopted in 2001. The plan is based upon the achievement of bank performance standards, which are approved by the bank board's Compensation Committee, annually. In addition, certain select bank employees participate in a retention plan which was determined at the discretion and approval of the bank board's Compensation Committee. The Farm Credit Bank of Texas Employee Retention Plan is an unfunded nonqualified deferred compensation plan that was created and approved by the bank's board of directors in 2007 as a means to induce specific employees to accomplish certain activities and remain with the bank for a defined period of time. Participants are nominated by the CEO and approved by the bank board's Compensation Committee. The Plan is constructed to be flexible as to the length of the retention period and the amounts paid for each year of successful participation in the Plan. Senior officers and other bank employees in the Plan are currently participating in individual three-year plans that pay a fixed percentage of their salary as long as they are still employed on the anniversary or ending date coincident with the effective date of each participant's Plan year.

Description of Property

On September 30, 2003, the bank entered into a lease for approximately 102,500 square feet of office space to house its headquarters facility. The lease was effective September 30, 2003, and the term is from September 1, 2003 to August 31, 2013. The bank moved into the new facilities during May of 2004.

Legal Proceedings

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

There are no legal proceedings pending against the bank and associations, the outcome of which, in the opinion of legal counsel and management, would materially affect the financial position of the bank and associations. Note 11, "Commitments and Contingencies," to the accompanying financial statements outlines the bank's position with regard to possible contingencies at December 31, 2008.

Description of Capital Structure

The bank is authorized to issue and retire certain classes of capital stock and retained earnings in the management of its capital structures. Details of the capital structures are described in Note 8, "Shareholders' Equity," to the accompanying financial statements, and in the "Management's Discussion and Analysis" included in this annual report to shareholders.

Description of Liabilities

The bank's debt outstanding is described in Note 7, "Bonds and Notes," to the accompanying financial statements. The bank's contingent liabilities are described in Note 11, "Commitments and Contingencies," to the accompanying financial statements.

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 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 financial statements in this annual report, is incorporated herein by reference.

Transactions With Senior Officers and Directors

The policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference to Note 10, "Related Party Transactions," to the accompanying financial statements.

Relationship With Public Accountants

There were no changes in independent public accountants since the prior annual report to shareholders, and there were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

The bank's Audit Committee approves all services provided by the the independent public accountants. During 2008, the bank paid its independent public accountants $274,185 for district audit services and $21,496 for bank audit services. During 2008, the non-audit services provided by the independent public accountants were approved by the bank's audit committee prior to commencement of these services. The non-audit services provided by PricewaterhouseCoopers consisted of an independent tally service for director elections. The billing for this service had not been received as of the date of this annual report.

Financial Statements

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 27, 2009, and the report of management in this annual report to shareholders, are incorporated herein by reference.

The Tenth Farm Credit District's annual and quarterly reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720 or by calling (512) 483-9204. Copies of the district's quarterly and annual stockholder reports can be requested by e-mailing fcb@farmcreditbank.com. The bank's and district's quarterly reports are available approximately 40 days after the end of each fiscal quarter. The bank's and district's annual reports will be posted on the bank's Web site (www.farmcreditbank.com) within 75 calendar days of the end of the bank's fiscal year. This posting coincides with an electronic version of the report being provided to its regulator, the Farm Credit Administration. Within 90 calendar days of the end of the bank's fiscal year, a copy of the bank's annual report will be provided to its stockholders.

Credit and Services to Young, Beginning and Small Farmers and Ranchers, and Producers or Harvesters of Aquatic Products (YBS)

In line with our mission, we have policies and programs for making credit available to young, beginning and small farmers and ranchers.

The definitions for YBS, as prescribed by FCA regulations, are provided below.

Young Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.

Beginning Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who had 10 years or less of experience at farming, ranching or producing or harvesting aquatic products as of the date the loan was originally made.

Small Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who normally generated less than $250,000 in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

For the purposes of YBS, the term "loan" means an extension of, or a commitment to extend, credit authorized under the Farm Credit Act, whether it results from direct negotiations between a lender and a borrower or is purchased from, or discounted for, another lender, including participation interests. A farmer/rancher may be included in multiple categories as they are included in each category in which the definition is met.

The bank and associations' efforts to respond to the credit and related needs of YBS borrowers are evidenced by the following table:

	At December 31, 2008	
	Number of Loans	Volume
(dollars in thousands)		
Total loans and commitments	78,153	$ 19,421,687
Loans and commitments to young farmers and ranchers	14,198	$ 2,049,505
Percent of loans and commitments to young farmers and ranchers	18.2%	10.6%
Loans and commitments to beginning farmers and ranchers	36,670	$ 7,435,725
Percent of loans and commitments to beginning farmers and ranchers	46.9%	38.3%

The following table summarizes information regarding new loans to young and beginning farmers and ranchers:

	For the Year Ended December 31, 2008	
	Number of Loans	Volume
(dollars in thousands)		
Total new loans and commitments	18,361	$ 6,534,125
New loans and commitments to young farmers and ranchers	3,215	$ 730,023
Percent of new loans and commitments to young farmers and ranchers	17.5%	11.2%
New loans and commitments to beginning farmers and ranchers	7,803	$ 2,258,746
Percent of new loans and commitments to beginning farmers and ranchers	42.5%	34.6%

The following table summarizes information regarding loans to small farmers and ranchers:

	At December 31, 2008				
	Annual Gross Sales				
(dollars in thousands)	$50 Thousand or Less	$50 to $100 Thousand	$100 to $250 Thousand	Over $250 Thousand	Total
Total number of loans and commitments	23,255	19,126	20,674	15,098	78,153
Number of loans and commitments to small farmers and ranchers	15,802	14,658	15,275	8,133	53,868
Percent of loans and commitments to small farmers and ranchers	68.0%	76.6%	73.9%	53.9%	68.9%
Total loans and commitments volume	$ 471,342	$ 1,091,689	$ 2,759,620	$ 15,099,036	$ 19,421,687
Total loans and commitments to small farmers and ranchers volume	$ 333,667	$ 854,047	$ 2,065,410	$ 5,298,646	$ 8,551,770
Percent of loans and commitments volume to small farmers and ranchers	70.8%	78.2%	74.8%	35.1%	44.0%

The following table summarizes information regarding new loans made to small farmers and ranchers:

	For the Year Ended December 31, 2008				
	Annual Gross Sales				
(dollars in thousands)	$50 Thousand or Less	$50 to $100 Thousand	$100 to $250 Thousand	Over $250 Thousand	Total
Total number of new loans and commitments	5,671	3,442	4,598	4,650	18,361
Number of new loans and commitments to small farmers and ranchers	3,790	2,615	3,228	2,031	11,664
Percent of new loans and commitments to small farmers and ranchers	66.8%	76.0%	70.2%	43.7%	63.5%
Total new loans and commitments volume	$ 124,808	$ 256,046	$ 760,749	$ 5,392,522	$ 6,534,125
Total new loans and commitments to small farmers and ranchers volume	$ 96,320	$ 194,141	$ 527,441	$ 1,511,705	$ 2,329,607
Percent of loan and commitment volume to small farmers and ranchers	77.2%	75.8%	69.3%	28.0%	35.7%