COOPERATIVE ADVANTAGE

COMPETITIVE EDGE

2005 ANNUAL REPORT

FARM CREDIT BANK OF TEXAS

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FARM CREDIT BANK OF TEXAS
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A well-run cooperative —

one that is managed

efficiently, pays patronage

and operates in the best

interest of its customers — is its

competitor's worst nightmare.

Larry Doyle
Chief Executive Officer
Farm Credit Bank of Texas

COOPERATIVE ADVANTAGE

The Farm Credit Bank of Texas has a long and successful history of financing agriculture and rural America. We have remained a leading source of credit and financial services for rural Americans for almost 90 years, and we are proud that 2005 was yet another outstanding year for the Bank.

Success

Such sustained success is rooted in our cooperative structure. The Farm Credit Bank of Texas is a federated cooperative that provides funding and services to our owners, 21 local financing cooperatives in Alabama, Louisiana, Mississippi, New Mexico and Texas, and four Other Financing Institutions (OFIs). Our lending co-ops, or associations, in turn provide loans and financial services to their owner-customers — approximately 48,500 farmers, ranchers, agribusiness firms, country homeowners and other rural landowners. Together, the Bank and associations compose the Tenth Farm Credit District, which is part of the Farm Credit System, a $140-billion nationwide network of financing cooperatives.

This cooperative ownership structure offers distinct business advantages. By leveraging this business model, we can outperform competitors.

COMPETITIVE EDGE

Through the Farm Credit System, the largest rural lender in the nation, we benefit from having a dependable source of funding — AAA-rated Farm Credit bonds and notes, which are sold in the nation's capital markets. In fact, our cost of funds is one of the lowest in the country, near to the U.S. Treasury's. Furthermore:

- We return earnings to our stockholders in the form of cash patronage. The more we earn, the more patronage we pay, which lowers our shareholders' cost of borrowing. It's our way of helping our owners to succeed.
- We participate in large loan opportunities with other Farm Credit System institutions, which helps diversify credit risk and generate additional earnings.
- Our cooperative structure allows us to share the cost of employee benefits programs, services and customer products with other Farm Credit lending institutions.
- Being locally owned, we understand our stockholders' market-based challenges and opportunities.

Because our stockholders are also our customers, our structure impels us to deliver low-cost funds, high-quality products, excellent service, trustworthiness, ethical business practices and community support.

It is this cooperative difference that gives Farm Credit Bank of Texas our competitive edge.

OUR STRATEGIC

Ralph W. "Buddy" Cortese
Chairman

Jon "Mike" Garnett
Vice Chairman

Jimmy Dodson

Kenneth Andrews

E D G E

"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."

The Farm Credit Bank of Texas is obsessed with the success of our customer-stockholders — 21 lending associations and four Other Financing Institutions. We operate in their best interest, knowing that when they succeed, we succeed.

The Bank's strategy is to increase profitability through enhanced operations, expanded investments and new financing opportunities, and to pass that profitability on to our stockholders in the form of lower-cost funds, patronage payments and enhanced technology and business tools. In so doing, we are helping our customers to better serve their stockholders — agricultural producers, agribusiness firms, rural homeowners and other rural landowners.

Ultimately, our goal is to neutralize our stockholders' cost of borrowing and to always be their lender and vendor of choice.

From Wall Street to Main Street, the Bank's board of directors oversees the flow of funds from the nation's capital markets through the Bank to our association stockholders. As part of the cooperatively owned Farm Credit System, we benefit from a low cost of funds that is close to the U.S. Treasury's.

FARM CREDIT BANK OF TEXAS
BOARD OF DIRECTORS

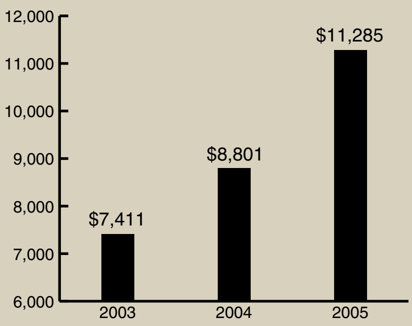
Joe Crawford **William Staats**

FINANCIAL HIGHLIGHTS

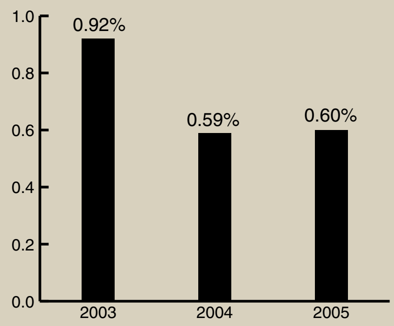
For the Year *(in thousands)*	**2005**	2004	2003
Net interest income	**$ 75,960**	$ 66,662	$ 49,826
Negative provision (provision) for loan losses	**344**	7,878	(340)
Noninterest (expense) income, net	**(18,688)**	(27,558)	15,338
Net income	**57,616**	46,982	64,824
Rate of return on:			
Average assets	**0.60%**	0.59%	0.92%
Average shareholders' equity	**10.57**	9.44	16.21
Cash patronage paid	**$ 28,713**	$ 16,775	$ 49,144

At Year End *(in millions)*			
Total loans	**$ 8,482**	$ 6,918	$ 5,835
Total assets	**11,285**	8,801	7,411
Total liabilities	**10,661**	8,300	6,933
Total shareholders' equity	**624**	501	478
Permanent capital ratio	**17.36%**	19.82%	23.71%
Total surplus ratio	**14.97**	16.55	19.15
Core surplus ratio	**8.82**	11.51	14.44
Net collateral ratio	**105.90**	105.69	106.62

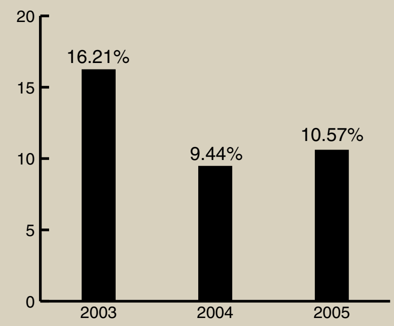
Total Assets Outstanding at Year End
(in millions)



Return on Average Assets
for the Year



Return on Average Equity
for the Year



2005 OUTSTANDING PERFORMANCE

The Farm Credit Bank of Texas turned in an outstanding financial performance in 2005, a testament to the simple cooperative business model that we have followed since 1916. Record growth, strong earnings and a record direct-loan patronage distribution to stockholders highlighted the year, which by most measures was our best ever.

Both net income and net loan volume increased by 22.6 percent from the previous year, and total assets grew by 28.2 percent. Credit quality remained extremely strong, while impaired loans constituted less than 0.1 percent of our loan portfolio. Moreover, the bank exceeded our regulator's minimum requirements for permanent capital, core surplus, total surplus and net collateral ratio.

We are most proud, however, that as a result of our continuing financial success we were able to pay a patronage dividend of 30 basis points on 2005 direct notes to our cooperative stockholders. This translated to $20.6 million of earnings returned to our affiliated lending associations and OFIs, which for district associations represented 11 percent of their combined net income for 2005.

It took the hard work and dedication of the entire Farm Credit Bank of Texas team working closely with our affiliated lending institutions to achieve these remarkable financial results. We look forward to achieving further success through cooperation in the years ahead.

Farm Credit Bank of Texas
Senior Management Team

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*

PULLING AHEAD

ACHIEVEMENTS

Beginning in 2003, the Farm Credit Bank of Texas set out on a new course — a five-year plan to increase the Bank's profitability with the goal of providing maximum value to our stockholders. Building on the tremendous momentum established by the Bank in 2003 and 2004, we set our sights for 2005 on further expanding our capital base, diversifying our balance sheet and enhancing our operating standards.

Capital and Growth

Our success, and the success of our association stockholders, depends to a large extent on our ability to increase capital and generate strong earnings. To this end, we are pleased to report the following accomplishments in 2005.

- Cash patronage totaling $28.7 million. This included $20.6 million — the equivalent of 30 basis points — of patronage paid on direct loans to Bank stockholders; $3.4 million of patronage on participation loans; and $4.7 million of patronage on our stockholders' investment in the Bank.
- The issuance of $100 million of cumulative perpetual preferred stock, a measure that has helped the Bank to maintain a strong capital and liquidity position. The stock was sold at a premium, resulting in net proceeds of $106.8 million and confirming the Bank's positive reputation in the investment marketplace. Proceeds are being used to meet stockholder associations' increased funding needs and pursue loan participations on their behalf.
- The sale of $100 million of participations in direct notes to CoBank, another Farm Credit System bank. This sale helped diversify our credit exposure profile and provided additional liquidity for our loan participation portfolio. At year end, CoBank held participations in our direct notes totalling $400 million.
- A 75 percent increase in the Bank's participation loan portfolio to $1.314 billion at December 31, 2005, from $752.5 million a year earlier.
- A $905 million, or 49 percent, increase in our investment portfolio, which consists of high-grade investments that support our liquidity strategy.
- Growth of 16.7 percent, or $1.018 billion, in our direct notes to Tenth District associations and OFIs from year-end 2004 to year-end 2005.

Products and Services

At Farm Credit Bank of Texas, we are continually upgrading our operations and the business tools and services that we offer to our stockholders. New in 2005 was an online pricing tool that helps loan officers provide quick rate quotes. We also launched a new line-of-credit cash management product, upgraded the district's loan origination system and started development of several additional credit tools. In addition, we enhanced our business continuity plan, building in new controls to ensure the flow of funds in the event of disaster.

In 2005, more than 500 association employees took advantage of credit and appraisal training courses coordinated by the Bank. The students ranged from veteran loan officers trying out new technology to Farm Credit freshmen learning the fundamentals of financing. Also during the year, nearly 150 association directors from all five states attended Director Development Programs, which covered everything from personnel issues to audit requirements.

Just as we view our investment in training as an investment in the future of Farm Credit, we believe that a culturally and ethnically diverse workforce is critical to the future success of our organization. Through increased community outreach and support, recruiting efforts and management training last year, we started the process of weaving diversity into the fabric of Farm Credit. This was a significant step that moves us toward a fundamental Bank goal: to assemble a top-notch staff that represents a mix of ideas, cultures, gender, educational backgrounds and skill sets. As we accomplish this goal, we will enhance our ability to meet the needs of an increasingly diverse marketplace.

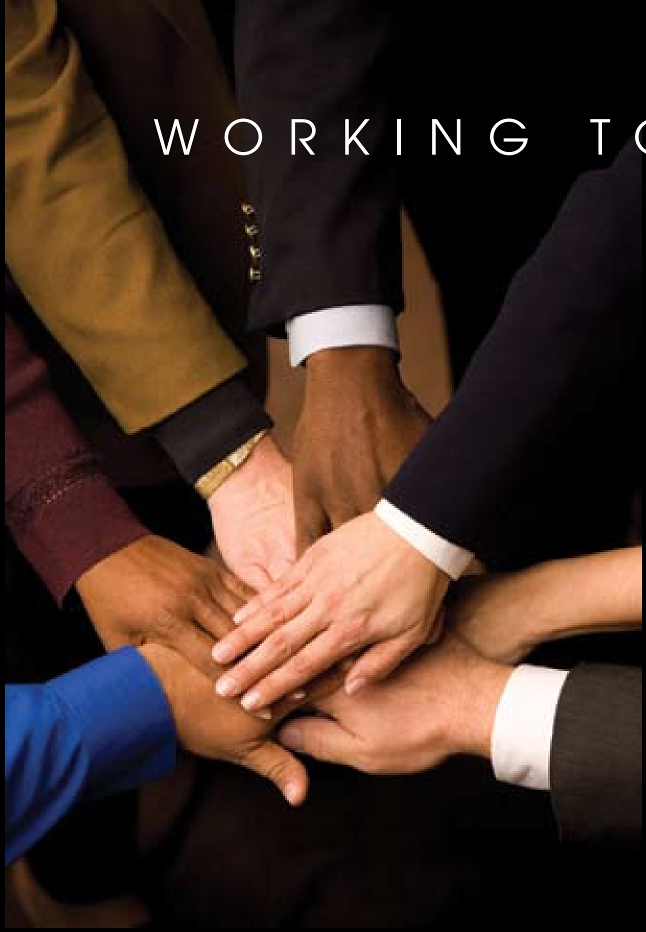
Relationships

Cooperatives are all about relationships, and last year, many of our achievements resulted from our relationships with other lenders.

This was especially true in the agribusiness-financing arena, where our Capital Markets Group forged new business relationships with 17 additional lenders. By year end, we had alliances with 55 Farm Credit entities and national banks. These relationships enabled us to provide capital and liquidity for national and multinational agribusiness firms, rural utilities and rural communications companies and, in turn, earn significant fee income. In addition, we formed strategic alliances with three major banks, Wachovia Corporation, JPMorgan Chase and Frost Bank, to provide innovative cash management tools for the benefit of our associations and their customers.

Meanwhile, at the local level, our Direct Lending Group worked closely with our Tenth District association stockholders in 2005 to help them penetrate their local markets. The relationship between the Bank and associations is an arm's-length commercial lending relationship; however, we worked with the associations on everything from marketing matters to loan structuring and pricing, frequently partnering with them on loans that exceeded their lending limits.

In keeping with the co-op principle of "cooperation among cooperatives," the Farm Credit Bank of Texas joined with AgFirst Farm Credit Bank in 2004 to cost-share an automated human resources system and a capital markets loan accounting system. To further control costs, we struck another agreement with AgFirst in 2005 — this time combining health and Thrift plans from both institutions to form a more effective and efficient employee benefits plan.



WORKING TOGETHER

OUR FUTURE

As last year's results proved, the higher we aim, the more we achieve. Entering 2006, we are energized by the success we enjoyed in 2005 and look forward to accomplishing even more in the future. All of our strategic objectives for the coming year are driven by our cooperative business model and focus on supporting our Tenth District association stockholders, either directly or indirectly.

In 2006, the Farm Credit Bank of Texas will continue a long-term strategy to increase earnings and spread overhead costs through loan participations and investments. The success of this strategy will be measured by increases in patronage to our association stockholders.

Also in 2006, we will move to a capital structure that emphasizes a classic cooperative business model. This will involve asking our stockholders to approve bylaw changes that support the allocation of retained earnings to more fully establish member ownership.

Our ongoing commitment is to provide competitive support services and business tools to our association stockholders. In 2006, we will deliver new cash management products, a new customer relationship management tool, and innovative new loan programs for use in the rural housing and agri-business markets. Also due to launch in 2006 is an economic capital model, which will assist us in the strategic decision of how to best leverage capital. In addition, we are planning a review of the Bank's loan accounting system, a measure that should result in more efficiency for our associations.

Perhaps our most significant investment in 2006, however, will be the investment we make in our Farm Credit people. While continuing our training programs for both association directors and employees, we will institute a formal employee-recruiting program for the associations. By hiring from a larger pool of candidates, these rural lending cooperatives will be better staffed to serve today's increasingly diverse and dynamic marketplace.

We view diversity as a business advantage, because a diverse workforce of talented professionals brings a rich perspective and broad customer knowledge that ultimately leads to strong financial performance and greater return to our stockholders. When we embrace the differences among people and make the most of those differences, we are ensuring the long-term success of our organization.

Established in 1916 to provide agriculture and rural America with a reliable source of competitive financing, the Farm Credit System has helped generations of farmers, ranchers, agribusiness owners and rural residents realize their dreams. From Maine to Hawaii, Farm Credit lending associations are respected as the experts in rural lending.

In the coming year, the Farm Credit Bank of Texas will leverage this reputation by launching a campaign to promote the Farm Credit brand throughout the Tenth District territory. In telling the story of Farm Credit to a broader audience, we intend to supplement the existing marketing efforts of our associations and educate Americans who may be searching for rural financing. At the same time, we will work with other Farm Credit System entities to implement solutions designed to support the ever-changing financing needs of the nation's rural communities.

The Farm Credit Bank of Texas has made tremendous progress in recent years in terms of growth, customer service, operating efficiencies and lowering our stockholders' cost of funds. Ensuring that we maintain this progress and continue to improve upon our solid foundation will be the focus of our attention in 2006.

Above all, we will remain true to our cooperative principles, for it is in our cooperative business model that we find our competitive edge.

Teamwork

It took the hard work and dedication of the entire Farm Credit Bank of Texas team working closely with our affiliated lending institutions to achieve these remarkable financial results. We look forward to achieving further success through cooperation in the years ahead.

REPORT OF MANAGEMENT

The financial statements of the Farm Credit Bank of Texas 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, 2005, 2004 and 2003.

Ralph W. Cortese
Chairman of the Board

Larry R. Doyle
Chief Executive Officer

Thomas W. Hill
Chief Financial Officer

March 1, 2006

FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

Farm Credit Bank of Texas

(dollars in thousands)	**2005**	2004	2003*	2002	2001
Balance Sheet Data					
Cash, federal funds sold and overnight investments	**$ 46,836**	$ 51,114	$ 28,265	$ 61,859	$ 48,804
Investment securities	**2,697,876**	1,787,706	1,518,102	785,071	503,978
Loans	**8,481,501**	6,918,236	5,834,929	5,826,951	5,111,193
Less allowance for loan losses	**142**	239	9,834	9,695	13,643
Net loans	**8,481,359**	6,917,997	5,825,095	5,817,256	5,097,550
Other property owned, net	**—**	—	529	2,615	373
Other assets	**58,717**	44,388	38,833	39,225	48,679
Total assets	**$ 11,284,788**	$ 8,801,205	$ 7,410,824	$ 6,706,026	$ 5,699,384
Obligations with maturities of one year or less	**$ 5,371,770**	$ 4,058,078	$ 2,487,260	$ 3,751,585	$ 3,911,788
Obligations with maturities greater than one year	**5,288,711**	4,241,696	4,445,935	2,585,463	1,461,130
Total liabilities	**10,660,481**	8,299,774	6,933,195	6,337,048	5,372,918
Preferred stock, net	**200,000**	100,000	100,000	—	—
Capital stock	**135,390**	118,323	109,787	109,896	93,938
Retained earnings	**315,047**	290,666	272,291	257,884	231,659
Accumulated other comprehensive (loss) income	**(26,130)**	(7,558)	(4,449)	1,198	869
Total shareholders' equity	**624,307**	501,431	477,629	368,978	326,466
Total liabilities and shareholders' equity	**$ 11,284,788**	$ 8,801,205	$ 7,410,824	$ 6,706,026	$ 5,699,384
Statement of Income Data					
Net interest income	**$ 75,960**	$ 66,662	$ 49,826	$ 45,091	$ 36,427
Negative provision (provision) for loan losses	**344**	7,878	(340)	2,902	(1,439)
Noninterest (expense) income, net	**(18,688)**	(27,558)	15,338	(15,526)	(10,110)
Net income	**$ 57,616**	$ 46,982	$ 64,824	$ 32,467	$ 24,878
Key Financial Ratios (unaudited)					
Rate of return on:					
Average assets	**0.60%**	0.59%	0.92%	0.53%	0.48%
Average shareholders' equity	**10.57%**	9.44%	16.21%	9.43%	7.96%
Net interest income to average earning assets	**0.80%**	0.85%	0.71%	0.74%	0.70%
Net charge-offs to average loans	**—**	0.03%	—	0.02%	—
Total shareholders' equity to total assets	**5.53%**	5.70%	6.45%	5.50%	5.73%
Debt to shareholders' equity (:1)	**17.08**	16.55	14.52	17.17	16.46
Allowance for loan losses to total loans	**—**	—	0.17%	0.17%	0.27%
Permanent capital ratio	**17.36%**	19.82%	23.71%	18.06%	18.10%
Total surplus ratio	**14.97%**	16.55%	19.15%	14.01%	14.01%
Core surplus ratio	**8.82%**	11.51%	14.44%	12.56%	12.82%
Net collateral ratio	**105.90%**	105.69%	106.62%	105.32%	105.33%
Net Income Distributions					
Net income distributions declared					
Preferred stock dividends	**$ 11,342**	$ 7,561	$ 798	$ —	$ —
Patronage distributions declared					
Cash	**28,713**	$ 16,775	$ 49,144	$ 3,615	$ 3,102
Allocated retained earnings	**837**	14	1,645	928	—

* As discussed more fully in the following pages, net income and certain profitability ratios for 2003 were affected by the one-time gain of $30.5 million from the sale of mineral interests in that year.

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, 2005, 2004 and 2003. 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 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 borrowers/shareholders. As of December 31, 2005, the Bank served 8 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.

Any statements contained in this Management's Discussion and Analysis that are not historical facts are forward-looking statements that involve risks and uncertainties. Such forward-looking statements are subject to the impact of economic conditions (both generally and more specifically in the markets in which the District operates), the impact of competition for the District's customers from other providers of financial services, the impact of government legislation or regulation, and other factors and risks detailed in this annual report.

Financial Highlights

- The aggregate principal amount of loans outstanding at December 31, 2005, was $8.5 billion, compared to $6.9 billion at December 31, 2004, and $5.8 billion at December 31, 2003, reflecting increases of 22.6 and 45.4 percent over December 31, 2004 and 2003, respectively.
- The Bank's investment portfolio at December 31, 2005, totaled $2.7 billion, compared to $1.8 billion at December 31, 2004, and $1.5 billion at December 31, 2003, reflecting increases of 49.3 and 78.0 percent over December 31, 2004 and 2003, respectively.
- Net income totaled $57.6 million for the year ended December 31, 2005, an increase of 22.6 percent compared to 2004.
- Net interest income for the year ended December 31, 2005, was $76.0 million, a 13.9 percent increase over the year ended December 31, 2004.
- Return on average assets and return on average shareholders' equity for the year ended December 31, 2005, were 0.60 and 10.57 percent, respectively, compared to 0.59 and 9.44 percent for 2004, respectively.
- In September 2005, the Bank issued an additional 100,000 shares of $1,000 Cumulative Perpetual Preferred Stock for net proceeds of $106.8 million, after expenses associated with the offering.
- Approximately $100 million of participations in five of the Bank's direct notes with the District Associations were sold, at par, to another System bank in February 2005.
- Patronage distributions declared and retained earnings allocated totaled $29.5 million in 2005, compared to $16.8 million in 2004.

Risk Management

The major risks to which the Bank is exposed are:

- **Credit risk** – Credit risk is the risk of loss due to borrower or counterparty default. Credit risk related to borrowers is the possibility of failure on the part of borrowers to repay loans under the terms to which the borrowers agreed and is discussed in the "Financial Condition" section of this Management's Discussion and Analysis (MD&A), in Note 4, "Loans and Allowance for Loan Losses" and in Note 13, "Financial Instruments With Off-Balance-Sheet Risk." Credit risk related to counterparties is the possibility of default on the part of a counterparty on a derivative financial instrument that has a positive fair value, and is discussed in the "Asset/Liability Management" section of the MD&A and in Note 15, "Derivative Instruments and Hedging Activity."
- **Interest rate risk and liquidity risk** – Interest rate risk is the exposure of the Bank's financial condition to adverse movements in interest rates. Liquidity risk is the risk that the Bank would be unable to fund increases in assets and meet obligations as they become due. These risks are discussed in the "Asset/Liability Management" section of the MD&A and in Note 15, "Derivative Instruments and Hedging Activity."
- **Operational and business risks** – Operational and business risks relate to the risk of loss resulting from inadequate or failed processes or systems, human factors or external events. The Bank maintains and monitors a business continuity plan which includes safeguards in the event of failures or damage that might affect its critical functions or systems infrastructure.

RESULTS OF OPERATIONS

Net Income

The Bank's net income of $57,616 for the year ended December 31, 2005, reflects an increase of 22.6 percent over 2004, while 2004 income of $46,982 decreased by 27.5 percent from 2003. The decrease from 2003 to 2004 reflects the recognition of a one-time gain of $30.5 million on the sale of the Bank's mineral interest rights holdings in 2003. The return on average assets was 0.60 percent for the year ended December 31, 2005, up from 0.59 percent reported for the year ended December 31, 2004. The return on average assets was 0.92 percent for the year ended December 31, 2003. Changes in the major components of net income for the referenced periods are outlined in the following table and discussion.

	2005 vs. 2004	2004 vs. 2003
Net income (prior period)	$ 46,982	$ 64,824
Increase (decrease) due to:		
Interest income	167,698	35,222
Interest expense	(158,400)	(18,386)
Net interest income	9,298	16,836
Provision for loan losses	(7,534)	8,218
Gain on sale of mineral rights	—	(30,494)
Noninterest income	1,614	(4,413)
Noninterest expense	7,256	(7,989)
Total change in net income	10,634	(17,842)
Net income	$ 57,616	$ 46,982

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, 2005, was $392,226, an increase of $167,698, or 74.7 percent, compared to 2004. This increase is primarily attributable to the effect of the increasing interest rate environment that prevailed during 2005 and, to a lesser extent, to an increase in average earning assets.

Total interest income for 2004 was $224,528, an increase of $35,222, or 18.6 percent, from 2003. This increase is primarily attributable to the combination of an increase in average earning assets and the effect of an increase in the average yield on these assets.

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

	Year Ended December 31,	
	2005 vs. 2004	2004 vs. 2003
Increase in average earning assets	$ 1,678,915	$ 829,251
Average yield (prior year)	2.86%	2.69%
Interest income variance attributed to change in volume	48,017	22,307
Average earning assets (current year)	9,536,169	7,857,254
Increase in average yield	1.25%	0.17%
Interest income variance attributed to change in yield	119,681	12,915
Net change in interest income	$ 167,698	$ 35,222

Interest Expense

Total interest expense for the year ended December 31, 2005, was $316,266, an increase of $158,400, or 100.3 percent, compared to the same period of 2004. Total interest expense for 2004 was $157,866, an increase of $18,386, or 13.2 percent, from 2003. The increase in interest expense for 2005 compared to 2004 was primarily attributable to increasing interest rates and, to a lesser extent, to an increase in the amount of average interest-bearing liabilities. For the period 2004 as compared to 2003, the increase in interest expense is attributable to an increase in average interest-bearing liabilities and, to a lesser extent, to an increase in interest rates.

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

	Year Ended December 31,	
	2005 vs. 2004	2004 vs. 2003
Increase in average interest-bearing liabilities	$ 1,626,313	$ 723,853
Average rate (prior year)	2.15%	2.10%
Interest expense variance attributed to change in volume	34,966	15,201
Average interest-bearing liabilities (current year)	8,978,393	7,352,080
Increase in average rate	1.37%	0.05%
Interest expense variance attributed to change in rate	123,434	3,185
Net change in interest expense	$ 158,400	$ 18,386

Net Interest Income

Net interest income, the excess of interest income over interest expense, increased by $9,298 from 2004 to 2005, and increased by $16,836 from 2003 to 2004. The increase in 2005 was due to a $1.679 billion increase in average interest-earning assets offset by a 12 basis point decrease in the interest rate spread. Interest rate spread is the difference between the average rate received on interest-earning assets and the average rate paid on interest-bearing debt. The decrease in the interest rate spread is due to several factors. Competitive pricing on the Bank's participation loan portfolio has compressed the interest rate spread on those loans. The Bank has also issued longer-term debt in order to manage its interest rate risk profile. In addition, the Bank has increased its investment portfolio to enhance liquidity albeit at lower spreads.

Net interest income in 2004 was $16,836 greater than 2003. This increase was primarily due to an increase of $829,251 in average interest-earning assets and to an improvement of 12 basis points in the spread. The improvement in the interest rate spread was attributable to a reallocation into higher yield term securities as the investment portfolio size was increased to enhance both liquidity and earnings.

The impact of capital on net interest income increased by 7 basis points from 2004 to 2005, and by 2 basis points from 2003 to 2004. These increases were due to the effects of the increasing interest rate environment during these periods.

ANALYSIS OF NET INTEREST INCOME

	2005		2004		2003	
	Avg. Balance	**Interest**	Avg. Balance	Interest	Avg. Balance	Interest
Loans	**$ 7,501,731**	**$ 315,491**	$ 6,242,127	$ 175,907	$ 5,897,185	$ 165,037
Investments	**2,034,438**	**76,735**	1,615,127	48,621	1,130,818	24,269
Total earning assets	**9,536,169**	**392,226**	7,857,254	224,528	7,028,003	189,306
Interest-bearing liabilities	**8,978,393**	**316,266**	7,352,080	157,866	6,628,227	139,480
Impact of capital	**$ 557,776**		$ 505,174		$ 399,776	
Net Interest Income		**$ 75,960**		$ 66,662		$ 49,826

	Average Yield	Average Yield	Average Yield
Yield on loans	**4.21%**	2.82%	2.80%
Yield on investments	**3.77%**	3.01%	2.15%
Yield on earning assets	**4.11%**	2.86%	2.69%
Cost of interest-bearing liabilities	**3.52%**	2.15%	2.10%
Interest rate spread	**0.59%**	0.71%	0.59%
Impact of capital	**0.21%**	0.14%	0.12%
Net interest income/average earning assets	**0.80%**	0.85%	0.71%

Provision for Loan Losses

In 2005, the Bank recorded a $344 negative provision for loan losses, which was a decrease of $7,534 from the negative provision for loan losses of $7,878 recorded in 2004. This negative provision for 2004 was an $8,218 decrease from the $340 provision for loan losses recorded in 2003. In 2004, the Bank refined its allowance for loan loss methodologies, as further described in the "Allowance for Loan Losses" section of this MD&A.

Noninterest Income

Noninterest income for the year ended December 31, 2005, was $16,495, an increase of $1,614, or 10.8 percent, compared to 2004. The increase is primarily attributable to an increase of $2,176 in loan-related fees, partially offset by a $420 decrease in gains on sales of investments and a $125 decrease in fees for services performed for District Associations.

Noninterest income totaled $14,881 for 2004, a decrease of $34,907, or 70.1 percent from 2003. The decrease was primarily due to the Bank's gain of $30,494 on the sale of its mineral rights holdings in late 2003 and a decrease of $4,994 in mineral income received prior to the sale of the rights, which was included in "Miscellaneous income, net" in 2003. Mineral rights had been retained on foreclosed properties when the surface rights were sold prior to the amendment of the Farm Credit Act in 1987, and they were recorded at zero value on the balance sheet. The decline in fees for services to Associations of $1.9 million from 2003 to 2004 was the result of the continuing transition of certain service activities to the Associations.

Noninterest Expenses

Noninterest expenses totaled $35,183 for 2005, a decrease of $7,256, or 17.1 percent, from 2004. This decrease was primarily due to a $6,815 decrease in salaries and employee benefits, a $612 decrease in occupancy and equipment expenses, and a $192 decrease in other operating expenses. The effect of these decreases was offset by a $363 increase in intra-System financial assistance. The decrease in salaries and employee benefits was attributable to the recording of $7.8 million in a cumulative, actuarially calculated liability for non-pension retirement benefits in 2004, which resulted from a change in methodology followed by the Bank, as described below, and a decrease in pension and retirement expenses of $305, offset by an increase in compensation and related payroll taxes of $754 and an increase in employee medical and other benefits of $491. Occupancy and equipment declined as a result of the cost, in 2004, of leasing new corporate office space in addition to costs associated with occupancy of the old headquarters building for the first six months of 2004. The decrease in other operating expenses was primarily due to nonrecurring costs of $1,949 incurred during 2004 related to the sale of the Bank's old headquarters building and a decrease of $629 in assessments from the Farm Credit Banks Funding Corporation (Funding Corporation), significantly offset by a $1.1 million increase in professional and contract services, a $489 decrease in net gains on other property owned, a $263 increase in premiums paid to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), a $102 increase in travel expenses, and an $86 increase in advertising and member relations. The increase in professional fees and services was primarily related to services related to District compliance with System governance and controls initiatives as well as to another System bank for the use of their capital markets loan accounting system and their payroll and human resources system. Premiums to the intra-System financial assistance expense for 2005 included the maturity and retirement of the last of the remaining issuances of debt obligations at the end of the second quarter of 2005. All existing issuances of intra-System financial assistance have matured and been extinguished.

Noninterest expenses totaled $42,439 for 2004, an increase of $7,989, or 23.2 percent, over 2003. This increase was primarily due to a $6,045 increase in salaries and employee benefits, an increase of $4,083 in other operating expenses, and an increase of $863 in occupancy and equipment expense, offset by a decrease of $2,403 in intra-System financial assistance expense. The increase in salaries and employee benefits was attributable to the recording of the $7.8 million liability for non-pension retirement benefits in 2004, mentioned above, offset by a decline in salaries of $518, a decline in pension and retirement expense of $793 and a decline in medical insurance premiums of $303. The increase in other operating expenses of $4,083 was primarily attributable to the $1,949 related to the sale of the Bank's old headquarters building, to an increase in professional fees and services of $1,210, and to an increase of $816 in fees and assessments from the Funding Corporation, offset by an increase in the gains on sale of other property owned of $404. The increase in professional fees and services included services related to District compliance with System governance and controls initiatives as well as fees to another System bank for the use of their capital markets loan accounting system and their payroll and human resources system. Occupancy and equipment expense increased as a result of the cost of leasing new corporate office space in addition to costs associated with occupancy of the old headquarters building for the first six months of 2004. The decline in intra-System financial assistance expense is due to the maturity in July 2003 of three of the five remaining outstanding Financial Assistance Corporation (FAC) debt issuances.

In 2003, the Bank participated in the District's multi-employer health and welfare benefit plan, through which it provided substantially all employees with postretirement health care and life insurance benefits. In 2003 the assets, liabilities and cost of the multi-employer plan were not segregated or separately accounted for by the participating entities. Costs were recognized only to the extent of contributions to the plan. In 2004, the Bank adopted a single-employer plan to administer non-pension postretirement benefits. Under the new plan, the Bank no longer is jointly and severally liable with any other employers. The implementation of this new plan occurred in December 2004 and resulted in the recording of an expense and liability of $7.8 million, which was the unfunded accumulated benefit obligation for its retirees and employees, in accordance with Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions."

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,

	2005	2004	2003
Excess of net interest income over operating expense	**$ 41,509**	$ 24,104	$ 18,064
Operating expense as a percentage of net interest income	**45.4%**	63.8%	63.7%
Operating expense as a percentage of net interest income and noninterest income	**37.3**	52.2	31.9
Operating expense as a percentage of average loans	**0.46**	0.68	0.54
Operating expense as a percentage of average earning assets	**0.36**	0.54	0.45

Operating expense for 2004 included the $7.8 million liability for non-pension postretirement benefits described above. Noninterest income for 2003 included $30.5 million in nonrecurring gains on sales of mineral rights holdings. The Bank's ability to improve its operating expense statistics is due primarily to the growth in the Bank's loan and investments portfolios and, to a lesser extent, to the Bank's ability to control the growth of its operating expenses. The Bank's net interest income has increased 13.9 percent and 33.8 percent for the years ended December 31, 2005 and 2004, respectively, while operating expenses decreased 19.1 percent in 2005 and increased 34.0 percent in 2004.

FINANCIAL CONDITION

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 $8.482 billion at December 31, 2005, reflected an increase of $1.564 billion, or 22.6 percent, from December 31, 2004. The balance of $6.918 billion at December 31, 2004, reflected an increase of $1.083 billion, or 18.6 percent, from the $5.835 billion balance at December 31, 2003.

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

	December 31,		
	2005	2004	2003
Direct notes receivable from District Associations and OFIs	**84.1%**	88.3%	92.0%
Participations purchased	**15.5**	10.9	6.8
Other loans	**0.4**	0.8	1.2
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 acceptable during this period. Credit quality for all loans other than direct notes to Associations and OFIs classified (under the Farm Credit Administration's

Uniform Loan Classification System) as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable was 98.5, 98.6 and 96.0 percent at December 31, 2005, 2004 and 2003, respectively.

While loan participations purchased made up only 15.5 percent of the Bank's total loans at December 31, 2005, the Bank has undertaken an initiative to increase the size of its participations portfolio. To this end, in February 2005, the Bank sold, at par, an additional $100 million of participations in five of its direct notes receivable from Associations to another System bank, for a total of $400 million. The purpose of the sale was to diversify the credit exposure of the Bank by providing capital for liquidity and expansion of the capital markets loan participations portfolio. Also, in September 2005, the Bank issued an additional $100 million in cumulative, perpetual preferred stock described more fully in the "Capital" section of this MD&A. Proceeds from the sale of the preferred stock enhance the Bank's capital and liquidity and support the Bank's loan growth.

Association Direct Notes

As the table on page 20 illustrates, 84.1 percent of the Bank's portfolio consisted of direct notes from Associations and OFIs at December 31, 2005. Terms of loans to Associations are specified in a separate General Financing Agreement between each Association 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	**2005**	2004	2003
Livestock	**40%**	41%	41%
Crops	**15**	16	17
Timber	**13**	11	12
Cotton	**7**	8	10
Poultry	**4**	5	6
Dairy	**2**	2	2
Rural home	**1**	1	2
Other	**18**	16	10
Total	**100%**	100%	100%

Livestock operations, including fed cattle stockers and cow-calf operations, represented approximately 40 percent of the District's loan portfolio at year end. While the Bank and District Associations have a significant number of loans to cattle producers, nearly half of these loans are not dependent on agricultural income for repayment, and the majority are collateralized by real estate. Livestock operations have been impacted during 2005 and 2004 by the December 2003 discovery of bovine spongiform encephalopathy (BSE, or "mad cow disease") in the United States. Despite the effects of foreign embargoes on U.S. beef which resulted from this discovery, prices have remained strong. All sectors of the cattle industry remained profitable during 2005 and the reopening of foreign markets to U.S. beef would support profitability in 2006. However, access to foreign markets and its impact on American livestock operations is difficult to predict. At the end of 2005, domestic cattle supply remained tight; however, winter feeding conditions have been more costly. Deteriorating pasture conditions resulting from drought conditions in much of the District resulted in more cattle being put in feed lots, where rising protein meal prices are making winter feeding more costly.

Poultry production has been fair, and profit margins have remained strong in 2005 and 2004, during the periods affected by foreign bans on U.S. beef. However, the spread of high pathogenic avian influenza (HPAI) in Southeast Asia and parts of eastern Europe have impacted exports to some of those markets as demand from the affected countries and their purchasing neighbors has shifted. The impact of any potential outbreak in the U.S. is difficult to predict. U.S. poultry are generally raised indoors and are not as exposed to the migratory birds that carry the disease, and although there has been no incidence of the Asian HPAI in the U.S., domestic processors have increased their testing of their flocks.

Given the industry and government responses in the past to HPAI events and their demonstrated containment and eradication protocols, it is believed that any outbreak would be minimal and isolated.

Consumer concerns over the safety of poultry have recently reduced demand and prices, and may adversely affect profitability in the U.S. poultry industry. If this continues, the result could be an increase in nonperforming loans and provisions for loan losses on poultry-related loans. Given the current financial soundness of most of our borrowers in this industry, and the use of government guarantees, any decline in performance of these loans is not expected to have an adverse impact on the financial performance of the Bank or Associations.

During the third quarter of 2005, two hurricanes made landfall in the District. Despite the devastating effects of the hurricanes, the economic impact on District lenders is considered to be minimal. The Associations impacted by these events are well-capitalized, with excellent credit liquidity and asset quality. Crop-related loans and facilities are generally insured and will be supported by government disaster support, and a significant portion of crops from the region were already harvested.

District Associations serve all or part of five states. The following table illustrates the geographic dispersion of direct notes receivable from District Associations, by state:

	December 31,		
	2005	2004	2003
Texas	**73%**	71%	74%
Alabama	**10**	10	9
Mississippi	**8**	9	8
Louisiana	**8**	8	8
New Mexico	**1**	2	1
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.

Loans $5,000 or greater in size (which generally represent corporate agribusiness) make up approximately 14.7 percent of the District's loan volume outstanding. Approximately 62.9 percent of District loans outstanding are made up of loans of $1,000 or less, and loans less than $250 make up approximately 36.6 percent of outstanding loan volume.

Credit quality at the District's Associations at December 31, 2005, 2004 and 2003 remained strong, with greater than 97 percent acceptable for each of the three year ends. Association non-earning assets as a percentage of total loans at December 31, 2005, was 0.4 percent, compared to 0.5 percent and 0.9 percent at December 31, 2004 and 2003, respectively.

High-Risk Assets

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

	2005	2004	2003
Nonaccrual loans	**$ 3,542**	$ 2,325	$ 10,322
Formally restructured loans	**908**	618	633
Loans past due 90 days or more and still accruing interest	**147**	206	—
Other property owned, net	**—**	—	529
Total	**$ 4,597**	$ 3,149	$ 11,484

High-risk assets increased by $1,448, or 45.98 percent, from December 31, 2004, to $4,597 at December 31, 2005. The increase in nonaccrual loans is attributable to the addition during 2005 of $3.0 million in participation loans to one borrower, offset by repayments and reductions on other nonaccrual loans. At December 31, 2005, $3,416, or 96.4 percent, of loans classified as nonaccrual were current as to principal and interest, compared to $1,726 (74.2 percent) and $9,921 (96.1 percent) at December 31, 2004 and 2003, respectively. Other property owned, net, decreased from 2003 to 2004 due to the sale during 2004 of properties which had been acquired through foreclosure.

Allowance for Loan Losses

The allowance for loan losses at December 31, 2005, was $142, compared to $239 and $9,834 at December 31, 2004 and 2003, respectively. Because analysis indicates that an allowance on the Association direct notes is not warranted, the entire balance of the allowance for loan losses at December 31, 2005, and December 31, 2004, reflect reserves for risks identified in the Bank's participations and other loan portfolios.

During 2004, the Bank completed a study to further refine its allowance for loan losses methodologies, taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines. As a result of these studies and the resulting refinements in methodologies, during the fourth quarter of 2004 the Bank recorded a $7.9 million reversal of its allowance for loan losses.

The Bank's allowance for loan losses methodologies was adjusted and revised in the late 1980s to take into account the credit losses experienced in the mid-to-late 1980s, as a result of unusually adverse economic factors affecting American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Bank's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

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

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

The refinement in methodology resulted in calculated allowances for loan losses that were significantly less than the previously recorded balances due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised levels of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors.

While the reversals had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in subsequent periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk-bearing capacity of the Bank, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $501.7 million at December 31, 2004 (7.3 percent of Bank loans), as compared with $487.5 million at December 31, 2003 (8.4 percent of Bank loans).

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

	2005	2004	2003
Allowance for loan losses			
as a percentage of:			
Average loans	— %	— %	0.17%
Loans at year end			
Total loans	—	—	0.17
Participations	0.01	0.03	2.19
Nonaccrual loans	4.01	10.28	95.27
Total high-risk loans	3.09	7.59	89.77
Net charge-offs to average loans	—	0.03	—
Provision (negative provision)			
expense to average loans	—	(0.13)	0.01

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

Liquidity and Funding Sources

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 comprising primarily 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 Bank's liquidity policy states that the Bank will maintain cash and marketable investment securities equal to a minimum of 90 days of maturing debt obligations.

As of December 31, 2005, the Bank's investment portfolio consisted of the following:

	Amount	**Percent of Total**
Mortgage-backed securities	$ 1,722,663	63%
Money market instruments	550,914	20
Asset-backed securities	424,299	15
Total investment securities	2,697,876	98
Overnight investments	42,444	2
Total	$ 2,740,320	100%

The Bank's primary source of funds is Systemwide debt securities issued through the Federal Farm Credit Banks Funding Corporation. This funding is readily available to the Bank due to the System's high credit quality and standing in the capital markets. 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, 2005, the Bank had excess collateral of $633.2 million. Management expects the Bank to maintain sufficient collateral to permit its continued participation in Systemwide debt issuances in the foreseeable future.

The following tables provide a summary of the debt obligations of the Bank (dollars in millions):

	December 31,		
	2005	2004	2003
Bonds and term notes outstanding	**$ 9,155**	$ 7,500	$ 6,657
Average effective interest rate	**4.13%**	2.89%	2.04%
Average remaining life (years)	**1.8**	1.6	1.8
Discount notes outstanding	**$ 1,408**	$ 733	$ 230
Average effective interest rates	**4.11%**	1.96%	0.82%
Average remaining life (days)	**35**	20	19

	For the years ended December 31,		
	2005	2004	2003
Average interest-bearing liabilities outstanding	**$ 8,978**	$ 7,352	$ 6,628
Average interest rates on interest-bearing liabilities	**3.52%**	2.15%	2.10%

The Bank had no commercial bank lines of credit in use at December 31, 2003.

ASSET/LIABILITY MANAGEMENT

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 three 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 wide choice of payment frequencies, such as monthly, quarterly, semi-annual and annual payments. Additionally, the Bank offers a wide 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, 2005, which are expected to mature or reprice in each of the future time periods shown:

INTEREST RATE GAP ANALYSIS

as of December 31, 2005

	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	$ 4,738,341	$ 891,915	$ 461,948	**$ 6,092,204**	$ 1,748,629	$ 640,668	**$ 8,481,501**
Total investments	1,191,451	153,092	161,673	**1,506,216**	985,879	248,225	**2,740,320**
Total interest-earning assets	5,929,792	1,045,007	623,621	**7,598,420**	2,734,508	888,893	**11,221,821**
Interest-Bearing Liabilities							
Total interest-bearing funds*	6,013,278	720,000	510,000	**7,243,278**	2,600,000	720,000	**10,563,278**
Excess of interest-earning assets over interest-bearing liabilities	—	—	—	—	—	658,543	**658,543**
Total interest-bearing liabilities	6,013,278	720,000	510,000	**7,243,278**	2,600,000	1,378,543	**$ 11,221,821**
Interest rate sensitivity gap	$ (83,486)	$ 325,007	$ 113,621	**$ 355,142**	$ 134,508	$ (489,650)	
Cumulative interest rate sensitivity gap	$ (83,486)	$ 241,521	$ 355,142	**$ 355,142**	$ 489,650		

* 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 positive gap position, indicating that the Bank has an exposure to decreasing interest rates. This would occur when income on interest-earning assets decreases due to their maturing or repricing cycle sooner than maturing or repricing debt is replaced with debt at a lower cost. The cumulative gap, which is a static measure, does not take into consideration the options available to the Bank in order to manage this exposure, specifically the ability to exercise options on callable debt and replace it with lower-priced 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. The Bank manages its interest rate risk exposure well within this guideline. As of December 31, 2005, projected annual net interest income of the existing interest-earning assets and interest-bearing liabilities would decrease by $31, or less than 0.1 percent, if interest rates were to increase by 200 basis points, and would increase by $19,194, or 20.4 percent, if interest rates were to decrease by 200 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, 2005, based on the Bank's interest-earning assets and interest-bearing liabilities at December 31, 2005.

Net Interest Income

Scenario	Net Interest Income	% Change
400 BP Shock	$ 91,603	(2.6)%
200 BP Shock	94,019	less than (0.1)%
0 BP	94,050	—
- 200 BP Shock	113,244	20.4

Market Value of Equity

Scenario	Assets	Liabilities	Equity	% Change
Book value	$ 11,284,788	$10,660,481	$ 624,307	16.1%
+ 200 BP Shock	10,877,968	10,442,992	434,976	(19.1)
0 BP Shock	11,188,783	10,651,257	537,526	—
- 200 BP Shock	11,394,183	10,789,061	605,122	12.6

The Bank uses derivative financial instruments, consisting primarily of interest rate swaps, to manage its interest rate risk and liquidity position. 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, thereby creating synthetic floating-rate debt. In 2004, the Bank entered into two cash flow hedges which hedge the exposure to variability in expected future cash flows. 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, 2005, the Bank had fair value hedges outstanding with a notional amount of $882 million and a negative fair value of $11.5 million and cash flow hedges with a notional amount of $95 million and a positive fair value of $1.0 million. 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 diversifies counterparties in the Bank's transactions and monitors the credit ratings of all counterparties with whom it transacts. The Bank's activity in derivative financial instruments for 2005 is summarized in the table below:

Activity in Derivative Financial Instruments
(Notional Amounts)

(in millions)	
Balance, December 31, 2004	$ 1,925
Additions	107
Maturities/calls	(970)
Terminations	(85)
Balance, December 31, 2005	**$ 977**

Capital

Total shareholders' equity at December 31, 2005, was $624,307, compared to $501,431 and $477,629 at December 31, 2004 and 2003, respectively. The increases are due primarily to the issuance of preferred stock and increases in retained earnings. On September 26, 2005, FCBT issued an additional 100,000 shares of $1,000 Cumulative Perpetual Preferred Stock for net proceeds of $106.8 million, after expenses associated with the offering. The terms of the preferred stock are the same as for the 100,000 shares issued on November 7, 2003, for net proceeds of $98.6 million, after expenses 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 LIBOR plus 445.75 bps. The preferred stock qualifies as capital and is reflected as a separate line item in the Bank's balance sheet. The issuance of the preferred stock is a part of the Bank's actions to fund the expansion of its loan portfolio with higher earning participations, which contribute to a reduction in the cost of funds for the District's Associations.

The Bank paid out dividends of $11.3 million on preferred stock during 2005, including $9.2 million in dividends declared by the Bank and $2.1 million in accrued interest purchased by preferred shareholders in conjunction with the issuance of September 2005. The Bank declared cash patronage totaling $28.7 million during 2005, including $20.6 million in direct loan patronage, $3.4 million patronage on certain participations and $4.7 million patronage based on the Associations' and OFIs' stock investment in the Bank.

Accumulated other comprehensive loss increased $18.6 million, or 245.7 percent, to $26.1 million at December 31, 2005, from $7.5 million at December 31, 2004, due to an increase of $18.3 million in unrealized net losses on the Bank's investments and a decrease of $262 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. The $1.0 million total of unrealized gains on cash flow hedges represents the increase in their fair value since their inception early in 2004.

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,

	2005	2004	2003	Regulatory Minimum
Permanent capital ratio	**17.36%**	19.82%	23.71%	7.00%
Total surplus ratio	**14.97**	16.55	19.15	7.00
Core surplus ratio	**8.82**	11.51	14.44	3.50
Collateral ratio	**105.90**	105.69	106.62	103.00

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

OTHER

Contractual Interbank Performance Agreement

All banks in the System, the Federal Farm Credit Banks Funding Corporation and the FAC participate in the Contractual Interbank Performance Agreement (CIPA). The objective of the CIPA is to encourage districts to achieve and/or maintain higher levels of financial condition and performance by subjecting them to a scoring process based on district profitability, asset quality and capital adequacy, with penalties for weak liquidity and excessive interest rate risk. The District's composite CIPA score is in compliance with agreed-upon CIPA standards and is expected to remain so during 2006.

REPORT OF AUDIT COMMITTEE

The Audit Committee (Committee) is composed 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 2005, four Committee meetings were held. At the first of their meetings, the Committee approved the appointment of PricewaterhouseCoopers LLP (PwC) independent auditors for 2005.

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, 2005 (the "Audited Financial Statements") with management and PwC. The Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards No. 61, as amended (Communications With Audit Committees), and both PwC and the Bank's internal auditors directly provided reports on significant matters to the Committee.

The Committee discussed with appropriate respresentatives 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 2005 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
Ralph W. Cortese
Jon M. Garnett
C. Kenneth Andrews
Joe R. Crawford
James F. Dodson

Audit Committee Members

March 1, 2006

REPORT OF INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
300 West 6th Street
Suite 1800
Austin TX 78701
Telephone (512) 477 1300
Facsimile (512) 477 8681

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 the Farm Credit Bank of Texas (Bank) at December 31, 2005, 2004 and 2003, 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

March 1, 2006

BALANCE SHEETS

Farm Credit Bank of Texas

(*in thousands*)	December 31, 2005	2004	2003
Assets			
Cash	**$ 4,392**	$ 3,614	$ 6,465
Federal funds sold and overnight investments	**42,444**	47,500	21,800
Investment securities	**2,697,876**	1,787,706	1,518,102
Loans	**8,481,501**	6,918,236	5,834,929
Less allowance for loan losses	**142**	239	9,834
Net loans	**8,481,359**	6,917,997	5,825,095
Accrued interest receivable	**43,994**	26,032	19,194
Other property owned, net	**—**	—	529
Premises and equipment, net	**2,489**	2,416	957
Other assets	**12,234**	15,940	18,682
Total assets	**$ 11,284,788**	$ 8,801,205	$ 7,410,824
Liabilities and shareholders' equity			
Liabilities			
Bonds and notes, net	**$ 10,563,278**	$ 8,232,533	$ 6,886,738
Accrued interest payable	**60,113**	36,850	32,700
Intra-System financial assistance payable	**—**	—	280
Other liabilities	**37,090**	30,391	13,477
Total liabilities	**10,660,481**	8,299,774	6,933,195
Commitments and contingencies (Note 12)			
Shareholders' equity			
Preferred stock	**200,000**	100,000	100,000
Capital stock	**135,390**	118,323	109,787
Allocated retained earnings	**8,742**	9,980	14,237
Unallocated retained earnings	**306,305**	280,686	258,054
Accumulated other comprehensive loss	**(26,130)**	(7,558)	(4,449)
Total shareholders' equity	**624,307**	501,431	477,629
Total liabilities and shareholders' equity	**$ 11,284,788**	$ 8,801,205	$ 7,410,824

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

STATEMENTS OF INCOME
Farm Credit Bank of Texas

(*in thousands*)	Year Ended December 31, 2005	2004	2003
Interest Income			
Investment securities and other	**$ 76,735**	$ 48,621	$ 24,269
Loans	**315,491**	175,907	165,037
Total interest income	**392,226**	224,528	189,306
Interest Expense			
Bonds and notes	**316,201**	157,818	139,447
Notes payable and other	**65**	48	33
Total interest expense	**316,266**	157,866	139,480
Net Interest Income	**75,960**	66,662	49,826
(Negative provision) provision for loan losses	**(344)**	(7,878)	340
Net interest income after provision for loan losses	**76,304**	74,540	49,486
Noninterest Income			
Fees for services to Associations	**8,619**	8,744	10,624
Fees for loan-related services	**5,993**	3,817	3,071
Gain on sale of mineral rights	**—**	—	30,494
Gain from sale of investment securities	**—**	420	—
Miscellaneous income, net	**1,883**	1,900	5,599
Total noninterest income	**16,495**	14,881	49,788
Noninterest Expenses			
Salaries and employee benefits	**17,873**	24,688	18,643
Occupancy and equipment	**3,945**	4,557	3,694
Insurance Fund premiums	**579**	315	510
Gains on other property owned	**(29)**	(517)	(113)
Intra-System financial assistance expenses	**761**	398	2,801
Other operating expenses	**12,054**	12,998	8,915
Total noninterest expenses	**35,183**	42,439	34,450
Net Income	**$ 57,616**	$ 46,982	$ 64,824

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Farm Credit Bank of Texas

(in thousands)	Preferred Stock	Capital Stock	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2002	$ —	$ 109,896	$ 11,711	$ 246,173	$ 1,198	$ 368,978
Comprehensive income						
Net income	—	—	—	64,824	—	64,824
Unrealized net losses on investment securities	—	—	—	—	(5,647)	(5,647)
Total comprehensive income	—	—	—	64,824	(5,647)	59,177
Preferred stock issued	100,000	—	—	—	—	100,000
Issuance costs on preferred stock	—	—	—	(1,356)	—	(1,356)
Capital stock issued	—	6,638	953	—	—	7,591
Capital stock and allocated retained earnings retired	—	(6,747)	(72)	—	—	(6,819)
Cash dividends – preferred stock	—	—	—	(798)	—	(798)
Patronage						
Cash	—	—	—	(49,144)	—	(49,144)
Shareholders' equity	—	—	1,645	(1,645)	—	—
Balance at December 31, 2003	100,000	109,787	14,237	258,054	(4,449)	477,629
Comprehensive income						
Net income	—	—	—	46,982	—	46,982
Unrealized net losses on investment securities	—	—	—	—	(4,418)	(4,418)
Unrealized net gains on cash flow hedge derivatives	—	—	—	—	1,309	1,309
Total comprehensive income	—	—	—	46,982	(3,109)	43,873
Capital stock issued	—	9,122	—	—	—	9,122
Capital stock and allocated retained earnings retired	—	(586)	(4,271)	—	—	(4,857)
Cash dividends – preferred stock	—	—	—	(7,561)	—	(7,561)
Patronage						
Cash	—	—	—	(16,775)	—	(16,775)
Shareholders' equity	—	—	14	(14)	—	—
Balance at December 31, 2004	$ 100,000	$ 118,323	$ 9,980	$ 280,686	$ (7,558)	$ 501,431
Comprehensive income						
Net income	—	—	—	57,616	—	57,616
Unrealized net losses on investment securities	—	—	—	—	(18,310)	(18,310)
Unrealized net losses on cash flow hedge derivatives	—	—	—	—	(262)	(262)
Total comprehensive income	—	—	—	57,616	(18,572)	39,044
Preferred stock issued	100,000	—	—	—	—	100,000
Premium received on preferred stock net of issuance costs	—	—	—	6,773	—	6,773
Capital stock issued	—	17,170	—	—	—	17,170
Capital stock and allocated retained earnings retired	—	(103)	(2,075)	—	—	(2,178)
Cash dividends – preferred stock	—	—	—	(9,220)	—	(9,220)
Patronage						
Cash	—	—	—	(28,713)	—	(28,713)
Shareholders' equity	—	—	837	(837)	—	—
Balance at December 31, 2005	**$ 200,000**	**$ 135,390**	**$ 8,742**	**$ 306,305**	**$ (26,130)**	**$ 624,307**

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

STATEMENTS OF CASH FLOWS

Farm Credit Bank of Texas

(in thousands)		Year Ended December 31, 2005		2004		2003
Cash Flows From Operating Activities						
Net income	$	**57,616**	$	46,982	$	64,824
Reconciliation of net income to net cash provided by operating activities						
(Negative provision) provision for loan losses		**(344)**		(7,878)		340
Provision for losses on other property owned		**—**		39		132
Depreciation on premises and equipment		**645**		655		456
Accretion of net discount on loans		**(372)**		(210)		—
Amortization and accretion on debt instruments		**29,879**		3,913		(7,006)
Accretion of net (discount) premium on investments		**7,009**		(3,466)		(7,663)
Gains on sales of investment securities		**—**		(420)		—
Gain on sales of mineral rights		**—**		—		(30,494)
Loss (gains) on sales of other property owned, net		**36**		(511)		(409)
Loss on sales of premises and equipment		**5**		14		20
Increase in accrued interest receivable		**(17,962)**		(6,838)		(128)
Decrease (increase) in other assets, net		**862**		9,743		4,796
Increase (decrease) in accrued interest payable		**23,263**		4,150		(5,629)
Decrease in intra-System financial assistance payable		—		(280)		(4,054)
Increase (decrease) in other liabilities, net		**1,428**		(2,708)		2,869
Net cash provided by operating activities		**102,065**		23,699		8,462
Cash Flows From Investing Activities						
Net (increase) decrease in federal funds sold and securities purchased under resale agreements		**5,056**		(25,700)		32,169
Investment securities						
Purchases		**(4,653,111)**		(2,938,373)		(7,713,178)
Proceeds from maturities, calls and prepayments		**3,717,622**		2,582,672		6,982,163
Proceeds from sales		**—**		85,565		—
Increase in loans, net		**(1,662,682)**		(1,084,814)		(308,179)
Proceeds from sale of loans		**100,000**		—		300,000
Proceeds from sales of mineral rights, net		**—**		—		30,494
Proceeds from sales of other property owned, net		**—**		1,001		2,363
Proceeds from sales of premises and equipment		**190**		71		68
Expenditures for premises and equipment		**(913)**		(2,199)		(572)
Net cash used in investing activities		**(2,493,838)**		(1,381,777)		(674,672)
Cash Flows From Financing Activities						
Bonds and notes issued		**24,454,370**		92,467,455		32,137,344
Bonds and notes retired		**(22,149,048)**		(91,092,157)		(31,522,033)
Preferred stock issued, net of expenses		**106,773**		—		98,644
Capital stock issued		**17,170**		9,122		7,591
Capital stock retired and allocated retained earnings distributed		**(2,178)**		(4,857)		(6,819)
Cash dividends on preferred stock		**(9,220)**		(7,561)		(798)
Cash patronage distributions paid		**(25,316)**		(16,775)		(49,144)
Net cash provided by financing activities		**2,392,551**		1,355,227		664,785
Net increase (decrease) in cash		**778**		(2,851)		(1,425)
Cash at beginning of year		**3,614**		6,465		7,890
Cash at End of Year	$	**4,392**	$	3,614	$	6,465
Supplemental Schedule of Noncash Investing and Financing Activities						
Unrealized net loss on investment securities	$	**(18,310)**	$	(4,418)	$	(5,647)
Declared participations patronage payable		**3,396**		35		—
Supplemental Schedule of Noncash Changes in Fair Value Related to Hedging Activities						
Decrease in bonds and notes	$	**(2,097)**	$	(17,363)	$	(3,067)
Supplemental Disclosure of Cash Flow Information						
Interest paid	$	**297,389**	$	142,774	$	147,640

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 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), 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 8 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, 2005. 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 are responsible for supervising certain activities of the Associations within their districts. The FCBs and/or Associations make loans to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. Funds for the FCBs and the ACB are principally raised through the sale of consolidated Systemwide bonds and notes to the public, through the Federal Farm Credit Banks Funding Corporation (Funding Corporation).

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 members/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:

- 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 (FCSIC or Insurance Fund) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund also is available for the permissible uses of providing assistance to certain troubled and insured System institutions and for covering the operating expenses of the FCSIC.

Each System bank is insured and is required to pay premiums to the Insurance Fund until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the System's aggregate insured obligations (Systemwide debt obligations). When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. Premiums are based on the average principal outstanding of accrual and nonaccrual loans of the District for the year. At December 31, 2005, the assets in the Insurance Fund were approximately $2.1 billion; however, due to the other authorized uses of the Insurance Fund, there is no assurance that any available amount in the Insurance Fund will be sufficient to ensure the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon.

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.

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:

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.

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, 2005, 2004 and 2003. 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. Purchased premiums and discounts are amortized or accreted using a constant yield method (which is not materially different from the 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.

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.

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.

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.

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.

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 in excess of $50 thousand and amortizes them over the lives of the related loans on a straight-line basis.

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. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. See Note 4 for a discussion on the refinement of the allowance for loan losses methodologies.

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. The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors.

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 miscellaneous income.

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 straight-line method (which is not materially different from the effective interest method) over the term of related indebtedness.

In connection with past foreclosure and sale proceedings, the Bank retained certain mineral interests in land from which it received revenues from lease bonuses, rentals and royalties. These intangible assets were recorded at nominal or no value in the balance sheet. Income received from mineral and royalty holdings, net of related property taxes, in 2003 was $4,994, and is included in miscellaneous income in the statement of income. These mineral interests were sold in November 2003 for proceeds of $30.5 million, which is included in "gains on sale of mineral rights." Of this gain, $29.6 million was paid out as patronage to the District Associations in 2003.

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, 2005, 2004 and 2003.

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

G. Employee Benefit Plans:

The 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. Additionally, certain qualified individuals in the Bank may participate in a separate, supplemental pension plan. Within the plan, a certain percentage of employee contributions is matched by the Bank. The 401(k) plan costs are expensed as incurred.

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.

The Bank provides certain health care and life insurance benefits to eligible retired employees. No Bank employees hired on or after January 1, 2004, will be eligible for these health care and life insurance benefits upon retirement.

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, 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, 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.

Note 3 — Investment Securities

A summary of the amortized cost and estimated fair value of investment securities at December 31, 2005, 2004 and 2003, follows.

	December 31, 2005				
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Weighted Average Yield**
Commercial paper and other	**$ 550,981**	**$ —**	**$ (67)**	**$ 550,914**	**4.35%**
Collateralized mortgage obligations	**1,749,796**	**702**	**(27,835)**	**1,722,663**	**4.31**
Asset-backed securities	**424,276**	**118**	**(95)**	**424,299**	**4.62**
Total	**$ 2,725,053**	**$ 820**	**$(27,997)**	**$ 2,697,876**	**4.37%**

	December 31, 2004				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper and other	$ 170,744	$ 7	$ (6)	$ 170,745	2.33%
Collateralized mortgage obligations	1,592,344	1,019	(9,928)	1,583,435	3.58
Asset-backed securities	33,485	41	—	33,526	2.69
Total	$ 1,796,573	$ 1,067	$ (9,934)	$ 1,787,706	3.42%

	December 31, 2003				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper and other	$ 290,331	$ 56	$ (6)	$ 290,381	1.16%
Collateralized mortgage obligations	1,196,072	2,586	(7,225)	1,191,433	3.17
Asset-backed securities	36,148	144	(4)	36,288	1.36
Total	$ 1,522,551	$ 2,786	$ (7,325)	$ 1,518,102	2.72%

A summary of expected maturity, amortized cost, estimated fair value and weighted average yield of investment securities at December 31, 2005, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
Due in one year or less	$ 550,981	$ 550,914	4.35%
Due after one year through five years	—	—	—
Due after five years through ten years	117,485	113,954	3.95
Due after ten years	2,056,587	2,033,008	4.40
Total securities	$ 2,725,053	$ 2,697,876	4.37%

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, 2005, the CMO portfolio had a weighted average remaining life of approximately two years.

Proceeds and related gains and losses on sales of investment securities follow:

	Year Ended December 31,		
	2005	2004	2003
Proceeds on sales	**$ —**	$ 85,565	$ —
Realized gains	**—**	420	—

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

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 position at December 31, 2005. The continuous loss position is based on the date the impairment occurred. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. The Bank has both the ability and the intent to recover substantially all of our cost in these investments.

(in thousands)	**Less Than 12 Months**		**Greater Than 12 Months**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Mortgage-backed securities	$ 553,263	$ (5,318)	$ 907,993	$ (22,517)
Commercial paper	450,914	(67)	—	—
Asset-backed securities	126,022	(95)	—	—
Total	$ 1,130,199	$ (5,480)	$ 907,993	$ (22,517)

Note 4 — Loans and Allowance for Loan Losses

Loans comprised the following categories at December 31:

	2005	2004	2003
Direct notes receivable from District Associations and OFIs	**$ 7,128,339**	$ 6,110,098	$ 5,368,509
Participations purchased	**1,314,500**	752,549	395,419
Other loans	**38,662**	55,589	71,001
Total loans	**$ 8,481,501**	$ 6,918,236	$ 5,834,929

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	2005	2004	2003
Livestock	**40%**	41%	41%
Crops	**15**	16	17
Timber	**13**	11	12
Cotton	**7**	8	10
Poultry	**4**	5	6
Dairy	**2**	2	2
Rural home	**1**	1	2
Other	**18**	16	10
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, 2005, 2004 and 2003.

	December 31,		
	2005	2004	2003
Nonaccrual loans			
Current as to principal and interest	**$ 3,416**	$ 1,726	$ 9,921
Past due	**126**	599	401
Total nonaccrual loans	**3,542**	2,325	10,322
Impaired accrual loans			
Restructured accrual loans	**908**	618	633
Accrual loans 90 days or more past due	**147**	206	—
Total impaired accrual loans	**1,055**	824	633
Total impaired loans	**$ 4,597**	$ 3,149	$ 10,955
Average impaired loans	**$ 4,887**	$ 8,929	$ 6,865

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans for the years ended December 31:

	2005	2004	2003
Interest income recognized on nonaccrual loans	**$ 635**	$ 1,325	$ 378
Interest income on impaired accrual loans	**84**	114	81
Interest income recognized on impaired loans	**$ 719**	$ 1,439	$ 459

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

	2005	2004	2003
With related specific allowance	**$ 3,137**	$ 1,286	$ 638
With no related specific allowance	**1,460**	1,863	10,317
Total impaired loans	**$ 4,597**	$ 3,149	$ 10,955
Allowance on impaired loans	**$ 142**	$ 239	$ 291

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:

	2005	2004	2003
Interest income which would have been recognized under the original loan terms	**$ 1,103**	$ 1,994	$ 1,004
Less: interest income recognized	**719**	1,439	459
Foregone interest income	**$ 384**	$ 555	$ 545

Refinement of the Allowance for Loan Losses Methodology

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

The Bank's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account credit losses in that period. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Bank allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

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

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

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

While the $7.9 million reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in subsequent periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk-bearing capacity of the Bank, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $501.7 million at December 31, 2004, or 7.3 percent of Bank loans, as compared with $487.5 million at December 31, 2003, or 8.4 percent of Bank loans.

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

	December 31, 2005	December 31, 2004	December 31, 2003
Balance at beginning of year	**$ 239**	$ 9,834	$ 9,695
(Negative provision) provision for loan losses	**(344)**	—	340
Nonrecurring negative provision for loan losses		(7,878)	—
Loans charged off	**—**	(5,725)	(201)
Recoveries	**247**	4,008	—
Balance at end of year	**$ 142**	$ 239	$ 9,834

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 $122.0 million at December 31, 2005. Fees paid to Farmer Mac for such commitments are paid by the Associations.

In November 2003 the Bank sold, at par, $300 million of participations in five of its direct notes with District Associations to another System bank. In February 2005, an additional $100 million of participations were sold. The purpose of the sale was to diversify the credit exposure of the Bank by allowing the acquisition of mortgage-type investment securities and interests in other capital market loan participations.

Note 5 — Premises and Equipment

Premises and equipment comprised the following at:

	December 31, 2005	December 31, 2004	December 31, 2003
Buildings and leasehold improvements	**$ 929**	$ 929	$ 22
Furniture and equipment	**7,244**	9,170	10,098
	8,173	10,099	10,120
Accumulated depreciation	**(5,684)**	(7,683)	(9,163)
Total	**$ 2,489**	$ 2,416	$ 957

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.

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

	Minimum Lease Payments
2006	$ 1,264
2007	1,366
2008	1,503
2009	1,674
2010	1,776
Subsequent years	5,123
Total minimum lease payments	$ 12,706

Note 6 — Other Assets and Other Liabilities

Other assets comprised the following at December 31:

	2005	2004	2003
Unamortized debt issue costs	**$ 4,316**	$ 3,181	$ 2,743
Accounts receivable	**4,130**	8,137	2,809
Fair value of derivatives	**1,047**	2,469	8,711
Land investment	**—**	—	793
Other, net	**2,741**	2,153	3,626
Total	**$ 12,234**	$ 15,940	$ 18,682

Other liabilities comprised the following at December 31:

	2005	2004	2003
Fair value of derivatives	**$ 11,538**	$ 10,601	$ 790
Obligation for non-pension postretirement benefits	**9,864**	9,634	2,034
Accounts payable	**3,963**	2,784	2,024
Patronage payable	**3,396**	35	—
Supplemental pension	**2,593**	1,766	2,296
Mortgage life additional reserve	**1,749**	1,757	1,912
Accrued building lease payable	**1,410**	1,098	—
Notes payable	**1,142**	1,903	3,112
FCSIC premium payable	**579**	315	510
Other, net	**856**	498	799
Total	**$ 37,090**	$ 30,391	$ 13,477

Note 7 — Bonds and Notes

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, 2005, the Bank had such specified eligible assets totaling $11.2 billion and obligations and accrued interest payable totaling $10.6 billion, resulting in excess eligible assets of $633.2 million.

In 1994, the System banks and the Funding Corporation 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, 2005, 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, 2005, 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
2006	$ 3,795.3	3.76%	$ 71.5	5.98%	$ 1,407.8	4.11%	$ 5,274.6	3.88%
2007	2,801.9	3.99	—	—	—	—	2,801.9	3.99
2008	763.0	4.28	20.0	5.57	—	—	783.0	4.31
2009	535.0	4.54	—	—	—	—	535.0	4.54
2010	500.0	5.12	—	—	—	—	500.0	5.12
Subsequent years	668.8	5.35	—	—	—	—	668.8	5.35
Total	$ 9,064.0	4.11%	$ 91.5	5.89%	$ 1,407.8	4.11%	$ 10,563.3	4.13%

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, 2005, was 35 days.

The Bank's Systemwide debt includes callable debt, consisting of the following at December 31, 2005 *(dollars in thousands)*:

Year of Maturity	Amount	Range of First Call Dates
2006	$ 260,000	1/1/2006-6/15/2006
2007	455,000	1/1/2006-1/26/2006
2008	580,000	1/1/2006-8/25/2006
2009	455,000	1/1/2006-12/28/2007
2010	430,000	1/1/2006-12/27/2007
Subsequent years	415,000	1/1/2006-12/22/2010
Total	$ 2,595,000	1/1/2006-12/22/2010

Callable debt may be called on the first call date and, generally, everyday thereafter with seven days' notice.

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.

The Bank had no outstanding commercial bank lines of credit at December 31, 2005.

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 2005, preferred stock dividends of $9,220 were declared and paid. At December 31, 2005, accumulated dividends on the preferred stock totaled $672.

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 26,754 shares, 23,500 shares and 21,856 shares of Class A voting common stock issued and outstanding at December 31, 2005, 2004 and 2003, 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 324 shares, 164 shares and 102 shares of Class A nonvoting common stock issued and outstanding at December 31, 2005, 2004 and 2003, respectively.

Allocated retained earnings of $8,742 at December 31, 2005, consisted of $7,892 of patronage refunds allocated to certain PCAs, and $850 allocated for the payment of patronage on loans participated with another System bank. The $7,892 in patronage refunds is used to satisfy all or part of the 2 percent Bank stock requirement by certain of the PCAs, all of which are now subsidiaries of ACA parent companies. Bank management's intent is to permanently invest these undistributed earnings in the Bank and to indefinitely postpone their conversion to cash.

Allocated retained earnings of $9,980 at December 31, 2004, consisted of $9,966 of patronage refunds allocated to certain PCAs prior to January 1, 1993, and $14 allocated for the payment of patronage on a loan participated with another System bank.

Allocated retained earnings of $14,237 at December 31, 2003, consisted of $2,573 allocated to certain participating Associations from earnings generated by the Bank's participation loans, which was revolved to the Associations in 2004, and $11,664 of patronage refunds allocated to certain PCAs as previously described.

At December 31, the Associations' investment in the Bank included the following investment in common stock and allocated retained earnings:

	2005	2004	2003
Class A voting common stock – Associations	**$ 133,772**	$ 117,501	$ 109,278
Class A nonvoting common stock – Other Financing Institutions	**1,618**	822	509
Total common stock	**135,390**	118,323	109,787
Preferred stock	**200,000**	100,000	100,000
Allocated retained earnings			
Associations	**7,892**	9,966	14,237
Other entities	**850**	14	—
Total allocated retained earnings	**8,742**	9,980	14,237
Total capital stock and allocated retained earnings	**$ 344,132**	$ 228,303	$ 224,024

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 2005, $28,713 in cash patronages was declared to District Associations, OFIs and other entities, compared to $16,775 in 2004 and $49,144 in 2003.

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. 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:

	2005	2004	2003	Regulatory Minimum
Permanent capital ratio	**17.36%**	19.82%	23.71%	7.00%
Total surplus ratio	**14.97**	16.55	19.15	7.00
Core surplus ratio	**8.82**	11.51	14.44	3.50
Collateral ratio	**105.90**	105.69	106.62	103.00

Note 9 — Employee Benefit Plans

Employees of the Bank participate in either the District's defined benefit retirement plan (DB plan) or a District defined contribution plan (DC plan) and are eligible to participate in the District's 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, 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 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 in 1998 and beyond, to facilitate reorganization and/or restructuring. Additionally, certain qualified individuals in the Bank may participate in a separate, 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 and supplemental pension plan accumulated benefit obligations and plan assets are 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 obligations exceeded the net assets of both plans as a whole as of December 31, 2005.

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. DC plan participants direct the placement of their employers' contributions (4.0 percent of eligible compensation during 2005) made on their behalf into various investment alternatives.

The District also participates in a Districtwide 401(k) plan, which offers a pre-tax and after-tax compensation deferral feature. In 2003, the employers made contribution enhancements to employer contributions under the plan. Beginning January 1, 2003, employers matched 100 percent of employee contributions for the first 3 percent of eligible compensation and then matched 50 percent of employee contributions on the next 2 percent of eligible compensation, for a maximum employer contribution of 4 percent of eligible compensation. Effective January 1, 2006, the Districtwide 401(k) plan was merged with the AgFirst Farm Credit Employee Thrift Plan. The new plan is known as the AgFirst/FCBT 401(k) Benefit Plan.

The following table presents the Bank's retirement benefit expenses for the years ended:

	2005	2004	2003
Pension	**$ 1,897**	$ 2,196	$ 3,018
401(k) plan	**406**	411	383
Total	**$ 2,303**	$ 2,607	$ 3,401

The Bank provides certain health care and life insurance benefits to eligible retired employees. No Bank employees hired on or after January 1, 2004, will be eligible for these health care and life insurance benefits upon retirement.

Until 2004, the Bank participated in the District's multi-employer health and welfare plan, through which it provided substantially all employees with postretirement health care and life insurance benefits. Neither the assets, liabilities nor cost of the multi-employer plan were segregated or separately accounted for by participating entities. Costs were recognized only to the extent of contributions to the plan. In December 2004, the Bank adopted a new single-employer plan to provide the same benefits to its retirees, employees and directors. Under the new plan, the Bank will no longer be jointly and severally liable with any other employers. As such, the Bank has recorded a liability at December 31, 2004, of $9,634, which reflects the unfunded accumulated benefit obligation for its retirees and employees.

The following tables reflect the benefit obligation, cost and actuarial assumptions for the Bank's other postretirement benefits:

Liabilities and Assets	**2005**	2004
Accumulated postretirement benefit obligation, December 31	**$ (7,374)**	$ (9,869)
Fair value of plan assets	**—**	287
Funded status of plan	**(7,374)**	(9,582)
Unrecognized net transition obligation	**—**	—
Unrecognized prior service cost	**(3,212)**	(952)
Unrecognized net loss (gain)	**683**	813
Fourth quarter contributions	**39**	87
Accrued postretirement benefit cost	**$ (9,864)**	(9,634)
Amounts Recognized in the Balance Sheets		
Accrued benefit liability	**$ (9,864)**	$ (9,634)
Contribution and benefit payments		
Employer contributions	**$ 528**	$ 432
Participant contributions during 2005	**197**	
Benefits paid during 2005	**955**	

Weighted-Average Assumptions Used to Determine Obligations at Year End	**2005**	2004
Measurement date	**September 30**	September 30
Discount rate	**5.25%**	6.00%
Health care cost trend rate assumed for next year – medical (pre-/post-65)	**9.5%/7.0%**	11.0%/11.50%
Health care cost trend rate assumed for next year – Rx (pre-/post-65)	**13.5%/13.5%**	11.0%/11.50%
Ultimate health care cost trend rate (pre-/post-65)	**4.75%/4.75%**	5.00%/5.50%
Year that the rate reaches the ultimate trend rate	**2016**	2012

Total Cost for 2005	
Service cost	**$ 286**
Interest cost	**577**
Expected return on plan assets	**(2)**
Amortization of:	
Unrecognized prior service cost	**(153)**
Unrecognized net loss	**2**
Accrued postretirement benefit cost	**$ 710**

Expected Future Cash Flows	
Expected Benefit Payments (net of employee contribution):	
Fiscal 2006	**$ 340**
Fiscal 2007	**354**
Fiscal 2008	**359**
Fiscal 2009	**362**
Fiscal 2010	**366**
Fiscal 2011-2015	**1,563**
Expected Contributions:	
Fiscal 2006	**340**

At December 31, 2005, the Bank had an accrued benefit liability of $9,864 on its balance sheet. The total net postretirement benefit cost for 2005 was $710, and the Bank's employer contributions for 2005 totaled $528.

The September 30, 2005 valuation reflects the following changes:

- The discount rate used to determine benefit obligations was reduced from 6.0% to 5.25%.
- The future medical inflation assumption was refined to vary by claim type and Medicare eligibility. In addition, the ultimate trend rate was decreased from 5.0% to 4.75% and the grading period was lengthened.
- The impact of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 is reflected through plan provision for medical and prescription drug coverage to Medicare-eligible retirees and spouses through fully insured AARP Medicare Supplement policies and basic Medicare part"D"Coverage through a selected prescription drug plan.

Note 10 — Intra-System Financial Assistance

The FAC was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the FAC's issuance of $1.26 billion of 15-year U.S. Treasury–guaranteed debt. The interest rates on these issuances ranged from 8.80 percent to 9.45 percent. The proceeds from the debt offerings were used to fund existing intra-System financial assistance payables ($417 million), to purchase preferred stock from certain troubled System banks ($808 million), and for other purposes ($36 million).

Pursuant to the Farm Credit Act, the U.S. Treasury paid the interest on $844 million of the FAC bonds for the first five years of the respective terms of such bonds. The payment of interest on this debt is allocated between the U.S. Treasury and System banks during the second five years. As the result of growth of the System's surplus, the allocation provisions of the Farm Credit Act required that the banks pay 100 percent of the interest beginning in 1999.

Financial assistance was provided by the FAC to five System banks through its purchase of preferred stock of those institutions. Through 1994, four System banks redeemed their preferred stock in the amount of $419 million through the transfer of assets to the FAC. The FLB of Jackson, whose charter was canceled in January 1995, received $374 million of financial assistance for which the related preferred stock has not been redeemed.

All interest advanced by the U.S. Treasury had to be and was repaid by System banks in June 2005. System banks recorded their share of the liability based upon each bank's proportionate share of average accruing retail loan volume. To fund the repayment obligation, annual annuity-type payments were made by each bank to the FAC in an amount designed to accumulate, in total, including earnings thereon, the total amount of each bank's ultimate obligation.

The FAC assumed certain payables previously accrued by the Bank under the System's Capital Preservation Agreements and funded payment of such accruals by the issuance of 15-year U.S. Treasury–guaranteed debt. Under the Farm Credit Act, the System banks were required to fund the bonds upon maturity. Although GAAP required recognition in the financial statements of the Bank's liability to the FAC, the Farm Credit Act states that for all financial reporting purposes, this obligation should not be considered a liability of any System bank until the maturity of such debt. The obligation was paid in July 2003.

The Bank's financial assistance expense totaled $0.8 million, $0.4 million and $2.8 million for the years ended December 31, 2005, 2004 and 2003, respectively. At December 31, 2004, the Bank had a receivable for $459, which is included in other assets. The liability for financial assistance totaled $280 at December 31, 2003.

Note 11 — 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 $255,902, $147,728 and $142,909 for 2005, 2004 and 2003, 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, loan processing, marketing and other services. Income derived by the Bank from these activities was $8,619, $8,744 and $10,624 for 2005, 2004 and 2003, respectively, and was included in the Bank's noninterest income.

Note 12 — 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, 2005, were approximately $112.7 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 therefrom, will not be material in relation to the financial position or results of operations of the Bank.

Note 13 — 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 its borrowers and to manage its exposure to interest rate risk. In the normal course of business, various commitments are made to customers, including commitments to extend credit and standby letters of credit, which represent credit-related financial instruments with off-balance-sheet risk.

At any time, the Bank has outstanding a significant number of commitments to extend credit. The Bank also provides standby letters of credit to guarantee the performance of customers to third parties. 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. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. Credit-related financial instruments have off-balance-sheet credit risk, because only origination fees (if any) are recognized in the balance sheet (as other liabilities) for these instruments until the commitments are fulfilled or expire. Since many of the commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. The Bank's commitments to extend credit totaled $1.175 billion, $706.5 million and $107.2 million at December 31, 2005, 2004 and 2003, respectively. At December 31, 2005, the Bank had $60.1 million in outstanding standby letters of credit, issued primarily in conjunction with participation loans. The letters of credit are generally issued for terms up to one year or are annually renewable. The $263 fair value of these obligations at December 31, 2005, is based on the fees for the unexpired period remaining and is included in other liabilities.

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 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, 2005, 2004 and 2003. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market prices are generally not available for System financial instruments. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, discount rates, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

	December 31, 2005		December 31, 2004		December 31, 2003	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets						
Cash, federal funds sold, securities purchased under resale agreements and investment securities	**$ 2,744,712**	**$ 2,744,712**	$ 1,838,820	$ 1,838,820	$ 1,546,367	$ 1,546,367
Loans	**8,481,501**	**8,390,165**	6,918,236	6,864,564	5,834,929	5,835,743
Allowance for loan losses	**(142)**	**—**	(239)	—	(9,834)	—
Loans, net	**8,481,359**	**8,390,165**	6,917,997	6,864,564	5,825,095	5,835,743
Derivative assets	**1,047**	**1,047**	2,469	2,469	8,711	8,711
Financial liabilities						
Bonds and notes	**10,574,816**	**10,578,272**	8,241,974	8,274,094	6,878,817	6,937,980
Fair value adjustment of derivatives	**(11,538)**	**(11,538)**	(9,441)	(9,441)	7,921	7,921
Total bonds and notes	**10,563,278**	**10,566,734**	8,232,533	8,264,653	6,886,738	6,945,901
Financial assistance related liabilities	**—**	**—**	—	—	280	748
Derivative liabilities	**11,538**	**11,538**	10,601	10,601	790	790

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

A. Cash:

The carrying value is a reasonable estimate of fair value.

B. Federal Funds Sold, Securities Purchased Under Resale Agreements, and Investment Securities:

Fair value is based upon currently quoted market prices.

C. Loans:

Because no active market exists for the District's loans, fair value is estimated by discounting the expected future cash flows using the District'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 District'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 similar-maturity Treasury notes, assuming a constant estimated yield spread relationship between Systemwide bonds and notes and comparable Treasury notes.

E. Obligation to FAC:

Fair value of these obligations is determined by discounting the cumulative expected future cash outflows of all of the obligations using a discount rate commensurate with bonds having a similar maturity.

F. 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 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, 2005, the Bank had fair value hedges with a total notional amount of $882 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.

In 2004 the Bank entered into two cash flow hedges, with a total notional amount of $95 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 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. At December 31, 2005, the Bank had credit exposure totaling $0.5 million with one counterparty. The Bank does not anticipate nonperformance by this counterparty. 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.

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:

	Remaining Years to Maturity						
($ in millions)	Less than 1 year	1 to 5 Years	Total	Maturity Distribution Netting	Exposure	Collateral Held	Exposure Net of Collateral
Standard & Poors Credit Rating							
A+	$ .51	$ —	$ .51	$ —	$ .51	$ —	$ .51

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.

	Maturities of 2005 Derivative Products and Other Financial Instruments							
December 31, 2005 *($ in millions)*	2006	2007	2008	2009	2010	Subsequent Years	Total	Fair Value
Total debt obligations:								
Fixed rate	$ 2,809	$ 952	$ 783	$ 535	$ 500	$ 669	$ 6,248	$ 6,252
Weighted average interest rate	3.56%	3.56%	4.31%	4.54%	5.12%	5.35%	4.06%	
Variable rate	$ 2,465	$ 1,850	$ —	$ —	$ —	$ —	$ 4,315	$ 4,315
Weighted average interest rate	4.33%	4.22%	—	—	—	—	4.28%	
Total debt obligations	$ 5,274	$ 2,802	$ 783	$ 535	$ 500	$ 669	$ 10,563	$ 10,567
Weighted average interest rate	3.88%	3.99%	4.31%	4.54%	5.12%	5.35%	4.13%	
Derivative instruments:								
Receive fixed swaps								
Notional value	$ 632	$ 165	$ 75	$ —	$ —	$ 10	$ 882	$ (12)
Weighted average receive rate	2.98%	3.30%	3.47%	—	—	4.49%	3.10%	
Weighted average pay rate	4.56%	4.58%	4.55%	—	—	4.80%	4.57%	
Pay fixed swaps								
Notional value	$ 95	$ —	$ —	$ —	$ —	$ —	$ 95	$ 1
Weighted average receive rate	4.63%	—	—	—	—	—	4.63%	
Weighted average pay rate	2.32%	—	—	—	—	—	2.32%	

Note 16 — Selected Quarterly Financial Information (Unaudited)

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

	2005				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	**$ 18,539**	**$ 18,759**	**$ 18,516**	**$ 20,146**	**$ 75,960**
Negative provision for loan losses	**(96)**	**(248)**	**—**	**—**	**(344)**
Noninterest expense, net	**5,795**	**4,032**	**3,754**	**4,346**	**17,927**
FAC expense	**218**	**(5)**	**548**	**—**	**761**
Net income	**$ 12,622**	**$ 14,980**	**$ 14,214**	**$ 15,800**	**$ 57,616**

	2004				
	First	Second	Third	Fourth	Total
Net interest income	$ 15,326	$ 16,684	$ 16,161	$ 18,491	$ 66,662
Nonrecurring negative provision for loan losses	—	—	—	(7,878)	(7,878)
Noninterest expense, net	5,932	6,427	3,474	11,327	27,160
FAC expense	101	91	78	128	398
Net income	$ 9,293	$ 10,166	$ 12,609	$ 14,914	$ 46,982

	2003				
	First	Second	Third	Fourth	Total
Net interest income	$ 12,245	$ 12,682	$ 12,232	$ 12,667	$ 49,826
Provision for loan losses	340	—	—	—	340
Noninterest expense (income), net	3,682	1,987	2,733	(26,541)	(18,139)
FAC expense	1,163	1,695	80	(137)	2,801
Net income	$ 7,060	$ 9,000	$ 9,419	$ 39,345	$ 64,824

As discussed in Note 2,"Summary of Significant Accounting Policies," the Bank's mineral interests were sold in November 2003 for proceeds of $30.5 million, which is included in"Noninterest expense, net."

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	**2005**	2004	2003
Cash	**$ 47,455**	$ 40,555	$ 40,952
Loans	**8,774,807**	7,568,736	6,789,215
Less allowance for loan losses	**9,391**	10,378	166,652
Net loans	**8,765,416**	7,558,358	6,622,563
Accrued interest receivable	**129,467**	95,747	84,323
Other property owned, net	**3,902**	5,184	5,528
Other assets	**186,512**	181,656	159,623
Total assets	**$ 9,132,752**	$ 7,881,500	$ 6,912,989
Bonds and notes	**$ 7,430,075**	$ 6,336,917	$ 5,641,875
Other liabilities	**191,082**	147,434	96,573
Total liabilities	**7,621,157**	6,484,351	5,738,448
Capital stock and participation certificates	**75,593**	92,103	104,657
Retained earnings	**1,436,002**	1,305,046	1,069,884
Total shareholders' equity	**1,511,595**	1,397,149	1,174,541
Total liabilities and shareholders' equity	**$ 9,132,752**	$ 7,881,500	$ 6,912,989

	Year Ended December 31,		
Statement of Income Data	**2005**	2004	2003
Interest income	**$ 530,067**	$ 387,570	$ 355,600
Interest expense	**268,222**	152,932	143,328
Net interest income	**261,845**	234,638	212,272
Provision (negative provision) for loan losses	**1,428**	(151,953)	10,883
Net interest income after provision for loan losses	**260,417**	386,591	201,389
Noninterest income	**53,594**	43,152	69,329
Intra-System financial assistance expense	**1,144**	3,406	3,993
Other expense	**126,546**	147,635	109,416
Provision for income taxes	**639**	1,768	324
Net income	**$ 185,682**	$ 276,934	$ 156,985

DISCLOSURE INFORMATION AND INDEX

Disclosures Required by Farm Credit Administration Regulations

Description of Business

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 Bank provides credit and credit-related services to or for the benefit of the Agricultural Credit Associations (ACAs) and the Federal Land Credit Associations (FLCAs) of the Tenth Farm Credit District (District) in the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. The District's FLCAs and ACA parent associations, which contain wholly-owned FLCA and Production Credit Association (PCA) subsidiaries, are collectively referred to as Associations. A further description of territory served, entities eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations required to be disclosed in this section is 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 is 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 directors and senior officers of the Bank as of February 1, 2006:

DIRECTORS

Ralph W. Cortese joined the board in 1995, and his current term expires December 31, 2007. 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 Committee. In June 2003, he was appointed to the Farmer Mac board.

Jon M. Garnett began his first term on the board in 1999, and his current term expires December 31, 2007. He has served as board vice chairman since 2000. Prior to joining the Bank board, he was chairman of the Panhandle-Plains Federal Land Bank Association (FLBA) Board of Directors. In January 2003, he joined the national Farm Credit Council Board of Directors as a Tenth District representative. He also serves on the Bank's Audit Committee and the State Technical Committee for the Natural Resources Conservation Service. Garnett farms, feeds stocker cattle, and operates a custom haying and baling business near Spearman, Texas.

C. Kenneth Andrews began service on the board in 1994, and his current term expires 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 is chairman of the Tenth District Farm Credit Council and has represented the District on the national Farm Credit Council Board of Directors since 1996. He also serves on the Bank's Audit Committee.

Joe R. Crawford began his first term on the board in 1998, and his current term expires December 31, 2006. 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. Currently, he serves as a director on the board of the Federal Farm Credit Banks Funding Corporation and is a member of the Bank's Audit Committee. 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 will expire December 31, 2008. 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 currently serves on the Tenth District Farm Credit Council board and on the Bank's Audit Committee. Dodson grows cotton and milo and operates a seed sales business with his family in Robstown, Texas. He is on the board of Cotton Incorporated and holds other national farm leadership positions.

William F. Staats joined the board in 1997, and his current term will expire December 31, 2008. 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 and is chairman of the Bank's Audit Committee.

SENIOR OFFICERS

Name and Title	Time in Position	Experience — Past Five Years
Larry R. Doyle, *Chief Executive Officer*	2.5 years	Executive Vice President and Chief Operating Officer, AgFirst Farm Credit Bank
Thomas W. Hill, *Senior Vice President, Chief Financial Officer,* *Chief Operations Officer*	11 years 2 years	Senior Vice President, Chief Financial Officer, FCBT
Steven H. Fowlkes, *Senior Vice President,* *Chief Credit Officer*	8 years 2 years	Senior management and management positions, FCBT
David N. Clinton, *Senior Vice President, Chief Information Officer*	7 years	Senior management position, FCBT
William E. Zimmerman, *Senior Vice President, Corporate Affairs,* *General Counsel and Corporate Secretary*	18 years	Senior Vice President, Corporate Affairs, General Counsel and Corporate Secretary, FCBT

Compensation of Directors and Senior Officers

Directors of the Bank are compensated for service on the Bank's board. Compensation for 2005 was paid at the rate of $2,932 per month, the maximum allowed under the Farm Credit Administration's (FCA) "Annual Adjustment of Maximum Director Compensation for 2005." In addition to days served at board meetings, directors may serve additional days on other official assignments, and under exceptional circumstances the board may approve additional compensation, not to exceed 30 percent of the annual maximum. Information for each director for the year ended December 31, 2005, is provided below:

Board Member	Days Served at Board Meetings	Days Served on Other Official Assignments	Total Compensation Paid
Ralph W. Cortese	27.5	25.5	$ 35,178
Jon M. Garnett	25.0	39.5	35,178
C. Kenneth Andrews	24.0	30.5	35,178
Joe R. Crawford	23.0	27.0	35,178
James F. Dodson	19.5	26.5	35,178
William F. Staats	24.0	31.0	35,178
			$ 211,068

The following table summarizes the compensation paid to all senior officers of the bank during 2005, 2004 and 2003:

Summary Compensation Table

		Annual			
Name of Individual or Group	Year	Salary (a)	Bonus (b)	Other (c)	Total
Larry R. Doyle, Chief Executive Officer	2005	$ 440,017	$ 176,000	$ 24,750	$ 640,767
Larry R. Doyle, Chief Executive Officer	2004	440,000	100,000	25,072	565,072
Larry R. Doyle, Chief Executive Officer	2003	316,666	—	109,505	426,171
Arnold Henson, Chief Executive Officer, retired	2003	51,667	55,000	70,207	176,874
Aggregate number of senior officers: (includes Chief Executive Officer)					
6	2005	1,463,382	385,108	134,293	1,982,783
6	2004	1,396,992	298,247	125,766	1,821,005
8	2003	1,362,683	201,513	381,532	1,945,728

(a) Gross salary
(b) Incentive pay
(c) Other includes relocation benefits, retirement gifts, unused annual leave paid in conjunction with retirement, contributions to 401(k) and defined contribution plans, automobile benefits and premiums paid for life insurance.

Disclosure of the compensation paid during 2005 to any senior officer included in the table above is available and will be disclosed to shareholders of the institution and stockholders of the District's Associations upon written request.

Directors and senior officers are reimbursed for reasonable travel, subsistence and other related expenses while conducting Bank business. The aggregate amount of expenses reimbursed to directors in 2005, 2004 and 2003 totaled $120,436, $91,473 and $71,001, respectively. A copy of FCBT's travel policy is available to shareholders upon request.

Bank employees, including senior officers, can earn compensation above base salary through an annual success-sharing incentive plan, which the FCBT adopted during 2001. The plan is based upon the achievement of predetermined Bank performance standards, which are approved by the board of directors annually.

Description of Property

In November of 2002, the Bank sold the District headquarters building and 8.4 acres of land on which it was situated on the northeast side of Austin, Texas. As a part of the sale agreement, the Bank leased space in the building until June 2004. 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. The Bank's investment in property is further detailed in Note 5, "Premises and Equipment," to the accompanying financial statements.

Legal Proceedings

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 12, "Commitments and Contingencies," to the accompanying financial statements outlines the Bank's position with regard to possible contingencies at December 31, 2005.

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" of the Bank 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 and intra-System financial assistance rights and obligations are described in Note 12, "Commitments and Contingencies," and Note 10, "Intra-System Financial Assistance," to the accompanying financial statements.

Selected Financial Data

The selected financial data for the five years ended December 31, 2005, required to be disclosed, is incorporated herein by reference to the "Five-Year Summary of Selected Combined Financial Data" included in this annual report to shareholders.

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 Bank does not have lending authority to make loans to individual borrowers, and so has no loans to or transactions with its officers and directors.

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.

Financial Statements

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 1, 2006, and the report of management in this annual report to shareholders, are incorporated herein by reference.

The Bank's and the 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 District's quarterly reports are available approximately 45 days after the end of each fiscal quarter. The District's quarterly and annual stockholder reports also are available on its Web site at *www.farmcreditbank.com*.