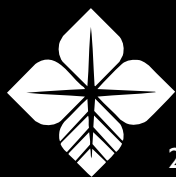




*The lender who can get you there*



2007 SECOND QUARTER REPORT  
TENTH FARM CREDIT DISTRICT  
JUNE 30, 2007

## ***SECOND QUARTER 2007***

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July 26, 2007

## **Management's Discussion and Analysis of Combined Financial Condition and Results of Operations**

*(dollars in thousands, except as noted)*

The following discussion reviews the combined financial condition and results of operations of the Farm Credit Bank of Texas (bank), the Federal Land Credit Associations (FLCAs) and the Agricultural Credit Associations (ACAs) of the Tenth Farm Credit District (district) for the three and six months ended June 30, 2007. FLCAs and ACAs are collectively referred to as associations. These comments should be read in conjunction with the accompanying combined financial statements and footnotes, along with the 2006 Annual Report to stockholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

### **RESULTS OF OPERATIONS**

#### *Net Income*

Net income for the quarter ended June 30, 2007, was \$44,301, a decrease of \$14,243, or 24.3 percent, from the quarter ended June 30, 2006. The \$14,243 decrease in net income for the second quarter of 2007 was due to a \$21,847 increase in provision for loan losses and a \$4,911 increase in noninterest expenses, offset by a \$12,409 increase in net interest income, a \$57 increase in noninterest income, and a \$49 decrease in provision for income taxes.

Net income for the six months ended June 30, 2007, was \$111,354, a decrease of \$3,759, or 3.3 percent, over the same period of 2006. The decrease in net income for the six months ended June 30, 2007, consisted of a \$22,116 increase in provision for loan losses and a \$9,627 increase in noninterest expenses, offset by a \$25,359 increase in net interest income, a \$2,566 increase in noninterest income, and a \$59 decrease in provision for income taxes.

#### *Net Interest Income*

Net interest income for the three months ended June 30, 2007, was \$106,186, an increase of \$12,409, or 13.2 percent, from the three months ended June 30, 2006. The increase in net interest income for the quarter ended June 30, 2007, was attributable to a volume increase of \$2.5 billion in the district's average earning assets, offset by a nine basis-point decrease in the district's net interest rate spread.

Net interest income for the six months ended June 30, 2007, was \$211,707, an increase of \$25,359, or 13.6 percent, over the same period of 2006. The increase in net interest income for the six months ended June 30, 2007, was attributable to a volume increase of \$2.7 billion in the district's average earning assets, offset by a 16 basis-point decrease in the district's net interest rate spread. The growth in interest-earning assets for the three and six months was primarily due to loan growth at the district's associations and to an increase in the bank's participations portfolio. Decreases in the district's interest rate spread for the three and six months were primarily due to increases in the district's average cost of debt, which outpaced the district's increases in average yield on interest-earning assets. Competitive pricing on district associations' loans and on the bank's participations portfolio have continued to compress the interest rate spread on those loans. The flat structure of the yield curve during the first six months of 2007 has also limited the district's ability to garner additional spread on debt issuance strategies in that many borrowers are moving to longer-term fixed-rate products.

#### *Provision for Loan Losses*

The district's provision for loan losses for the quarter ended June 30, 2007, was \$25,778, representing an increase of \$21,847 over the \$3,931 provision for the second quarter of 2006. Provision for loan losses

for the six months ended June 30, 2007, was \$27,020, reflecting an increase of \$22,116 over the same period of 2006. The increase in the provision was primarily due to specific allowances totaling \$24,739 by 12 district associations related to participations in a loan to one borrower, described more fully in the “Loan Portfolio” section of this discussion and analysis. The allowance at each period end was considered adequate by management to absorb probable losses existing in and inherent to its loan portfolio.

#### *Noninterest Income*

Noninterest income for the quarter ended June 30, 2007, was \$5,104, reflecting an increase of \$57, or 1.1 percent, over the same period of 2006. Noninterest income for the six months ended June 30, 2007, was \$12,243, reflecting an increase of \$2,566, or 26.5 percent, over the same period of 2006. The increase for the second quarter of 2007 over the same period of 2006 was due mainly to an \$817 increase in patronage income from another Farm Credit System entity, offset by a decrease of \$321 in net gains not related to other property owned, a \$393 decrease in other income, and a \$46 decrease in loan-related fees.

The \$2,566 increase in noninterest income for the six months ended June 30, 2007, compared to the same period of 2006 was due to a \$1,955 million increase in patronage income (primarily from another System bank), a \$543 gain on the sale of investments by the bank, and a \$425 increase in loan-related fees, offset by a \$255 decrease in other net gains not related to other property owned and by a \$103 decrease in other income.

#### *Noninterest Expense*

Noninterest expense for the three months ended June 30, 2007, was \$40,873, an increase of \$4,911, or 13.7 percent, over the same period of 2006. Noninterest expense for the six months ended June 30, 2007, was \$85,126, an increase of \$9,627, or 12.8 percent, over the same period of 2006. The increase for the second quarter is primarily attributable to a \$1,567 increase in salaries and employee benefits, a \$1,117 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), a \$357 increase in occupancy and equipment expenses, and a \$1,464 increase in other operating expenses. The \$1,567 increase in salaries and employee benefits was primarily due to a \$1,122 increase in compensation and related payroll taxes, a \$317 increase in pension and retirement expenses, and a \$128 increase in other benefits. Compensation increased due to increases in the number of employees and increases in compensation rates. Premiums to the Insurance Fund increased due to increases in the loan balances on which premium rates are applied. Other operating expenses increased due to a \$586 increase in advertising and member relations, a \$265 increase in insurance expense, a \$198 increase in supervisory and examination expenses, a \$119 increase in communications expense, and a \$106 increase in travel-related expenses, and a \$190 increase in all other expenses, collectively.

The \$9,627 increase in noninterest expense for the six months ended June 30, 2007, compared to the same period of 2006 was due mainly to a \$3,591 increase in salaries and employee benefits, a \$2,465 increase in premiums to FCSIC, a \$783 increase in occupancy and equipment expenses, and a \$2,501 increase in other operating expenses. The \$3,591 increase in salaries and employee benefits was primarily due to a \$2,741 increase in compensation and related payroll taxes, a \$777 increase in pension and retirement expenses, and a \$73 increase in other benefits. Other operating expenses increased due to a \$620 increase in advertising and member relations, a \$527 increase in professional and contract services, a \$262 increase in insurance expense, a \$261 increase in supervisory and examination expenses, a \$253 increase in directors’ expenses, a \$152 increase in training expenses, a \$143 increase in communications expense, and a \$283 increase in all other expenses, collectively.

**Key results of operations comparisons:**

	<b>Annualized for the Six Months Ended 6/30/2007</b>	Annualized for the Six Months Ended 6/30/2006
Return on average assets	<b>1.37%</b>	1.70%
Return on average members' equity	<b>10.32%</b>	11.64%
Net interest income as a percentage of average earning assets	<b>2.65%</b>	2.81%
Charge-offs, net of recoveries, to average loans	<b>0.24%</b>	0.06%
Operating expenses as a percentage of net interest income and noninterest income	<b>37.97%</b>	38.61%
Operating expenses as a percentage of average earning assets	<b>1.06%</b>	1.14%

**FINANCIAL CONDITION**

*Loan Portfolio*

Gross loan volume at June 30, 2007, was \$13,843,798, an increase of \$938,477, or 7.3 percent, from \$12,905,321 at December 31, 2006, and an increase of \$2,622,502, or 23.4 percent, from \$11,221,296 at June 30, 2006. The primary factors contributing to the growth in the district's loan volume included an increased focus on market share and loan growth opportunities within the territory, competitive pricing, increased marketing and customer service efforts by the associations, and growth in loan participations.

Overall credit quality in the district remained strong during the quarter. Loans classified as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable were 98.7 percent at June 30, 2007, decreasing slightly from 98.9 percent at December 31, 2006, and from 98.9 percent at June 30, 2006. Nonaccrual loans for the district were 0.6 percent of total loans at June 30, 2007, compared to 0.3 percent at December 31, 2006, and 0.4 percent at June 30, 2006. The \$25,301 allowance for loan losses at June 30, 2007, constituted 0.2 percent of total loans, and was considered by management to be adequate to absorb potential losses on existing loans.

Twelve associations in the district are participating in a loan to one borrower with total outstanding contractual principal of \$56.3 million at June 30, 2007. During the second quarter of 2007, the loan was deemed to be nonaccrual due to its significant undercollateralized position and a credit default. A specific reserve totaling \$24.7 million and a subsequent charge-off totaling \$15.2 million were recorded by the associations. The lead lending association is currently pursuing collection efforts regarding this loan. The bank does not have a participation interest in this loan.

Total district high-risk asset volume increased by \$58,641, or 127.0 percent, to \$104,823 at June 30, 2007, from \$46,182 at December 31, 2006.

Comparative balances of high-risk assets follow (in millions):

	<b>June 30, 2007</b>	<b>Increase (Decrease)</b>		<b>December 31, 2006</b>
		<b>\$</b>	<b>%</b>	
Nonaccrual loans	<b>\$ 82.8</b>	\$ 46.6	128.7 %	\$ 36.2
Formally restructured loans	<b>6.7</b>	(0.6)	(8.2)	7.3
Loans 90 days past due and still accruing interest	<b>13.1</b>	12.3	1,537.5	0.8
Total impaired loans	<b>102.6</b>	58.3	131.6	44.3
Other property owned, net	<b>2.2</b>	0.2	10.0	2.0
Total high-risk assets	<b>\$ 104.8</b>	\$ 58.5	126.3 %	\$ 46.3

The \$46,647 increase in nonaccrual loans includes the addition of participations held by 12 district associations in a loan to one borrower mentioned previously. The \$13,094 increase in loans past due 90 days or more and still accruing interest included bank participation loans to two borrowers totaling \$7,283. Impaired loans, consisting of nonaccrual loans, formally restructured loans, and loans past due 90 days or more and still accruing interest, constituted 0.7 percent of gross loans at June 30, 2007, and 0.3 percent of gross loans at December 31, 2006.

### *Liquidity and Funding Sources*

As of June 30, 2007, the Farm Credit Bank of Texas and all district associations exceeded all regulatory liquidity requirements. Cash and investment securities totaled \$2,667,746, or 15.9 percent, of total assets at June 30, 2007, compared to \$2,821,641, or 17.6 percent, at December 31, 2006, reflecting a decrease of \$153,895, or 5.5 percent. In March 2007, the bank sold investments with a book value of \$83.3 million for a gain of \$543. The sale was made for capital management purposes. Interest-bearing liabilities, consisting of bonds and notes, increased by \$771,944, or 5.7 percent, in order to fund the increases in loan volume.

The bank's investment portfolio includes \$290.3 million in securitizations of sub-prime mortgage, asset-backed securities. Due to the economic conditions currently affecting that market, the bank has reviewed internally the investments in question, and has consulted with outside analysts. Currently the bonds in question, which are rated Aaa and AAA by Moody's and Standard and Poor's, respectively, are not considered to be in jeopardy of credit downgrading due to the credit enhancement of the structures, the priority of payments assigned to the tranches, and the relatively short weighted average lives. However, prepayments are expected to slow as underwriting standards tighten in this market and this may extend the expected lives on these assets. The bank will continue to monitor these investments. Asset-backed securities represent 11 percent of the bank's investment portfolio.

### *Capital Resources*

Total members' equity increased \$90,658, or 4.3 percent, from December 31, 2006, to the June 30, 2007, total of \$2,203,318. This increase is the result of net income of \$111,354 for the six months ended June 30, 2007, and a net increase in capital stock of \$1,898, offset by retirements of association preferred stock and allocated earnings of \$503, patronage declared of \$12,647, dividends of \$7,561 on preferred stock, and an increase in unrealized net losses on investment securities totaling \$1,883. The change in unrealized losses on investment securities was due primarily to changes in the market value of fixed-rate

mortgage-backed securities, whose values have changed as interest rates have fluctuated during the period.

***Key financial condition comparisons:***

	<u>June 30, 2007</u>	<u>December 31, 2006</u>
Members' equity to assets	<b>13.11%</b>	13.21%
Total liabilities to members' equity	<b>6.63:1</b>	6.57:1
Allowance for loan losses to total loans	<b>0.18%</b>	0.11%

**OTHER**

***Prospective Accounting Changes***

On September 30, 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." The standard requires an employer to recognize the overfunded or underfunded status of postretirement benefit plans as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006, and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The district will be required to implement the standard for the year ended December 31, 2007. In addition, this standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the district uses a measurement date of September 30. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The district is currently evaluating the impact of implementing this standard. It is anticipated that the implementation of this standard will have no impact on the income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the balance sheet.

In February 2007, the FASB issued Statement of Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities." The standard permits entities to choose on an instrument-by-instrument basis, at special election dates, to measure eligible items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting date. Up-front costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This standard is effective for financial statements issued for fiscal years beginning after November 1, 2007.



Larry R. Doyle  
Chief Executive Officer



Ralph W. Cortese  
Chairman of the Board

## Combined Balance Sheets

(dollars in thousands)	June 30, 2007 (Unaudited)	December 31, 2006
<b>Assets</b>		
Cash	\$ 30,839	\$ 60,170
Federal funds sold and securities purchased under resale agreements	90,464	89,229
Investment securities	2,546,443	2,672,242
Loans	13,843,798	12,905,321
Less allowance for loan losses	25,301	13,969
Net loans	13,818,497	12,891,352
Accrued interest receivable	240,850	204,603
Other property owned, net	2,221	2,020
Premises and equipment, net	41,702	40,635
Other assets	29,548	26,816
<b>Total assets</b>	<b>\$ 16,800,564</b>	<b>\$ 15,987,067</b>
<b>Liabilities and members' equity</b>		
<b>Liabilities</b>		
Bonds and notes, net	\$ 14,292,728	\$ 13,520,784
Accrued interest payable	118,994	102,585
Patronage distributions payable	3,008	60,073
Other liabilities	182,516	190,965
<b>Total liabilities</b>	<b>14,597,246</b>	<b>13,874,407</b>
<b>Commitments and contingent liabilities (Note 3)</b>		
<b>Members' equity</b>		
Preferred stock, net	203,170	203,565
Capital stock and participation certificates	60,966	59,068
Allocated retained earnings	89,635	83,705
Unallocated retained earnings	1,877,831	1,792,723
Accumulated other comprehensive loss	(28,284)	(26,401)
<b>Total members' equity</b>	<b>2,203,318</b>	<b>2,112,660</b>
<b>Total liabilities and members' equity</b>	<b>\$ 16,800,564</b>	<b>\$ 15,987,067</b>

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

**Combined Statements of Income**  
(unaudited)

	<b>Quarter Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
(dollars in thousands)	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Interest Income</b>				
Investment securities	\$ 32,895	\$ 34,745	\$ 67,621	\$ 65,169
Loans	257,955	199,489	508,637	383,686
<b>Total interest income</b>	<b>290,850</b>	<b>234,234</b>	<b>576,258</b>	<b>448,855</b>
<b>Interest Expense</b>				
Bonds and notes	163,688	133,375	322,614	248,784
Notes payable and other	20,976	7,082	41,937	13,723
<b>Total interest expense</b>	<b>184,664</b>	<b>140,457</b>	<b>364,551</b>	<b>262,507</b>
<b>Net interest income</b>	<b>106,186</b>	<b>93,777</b>	<b>211,707</b>	<b>186,348</b>
Provision for loan losses	25,778	3,931	27,020	4,904
<b>Net interest income after provision for loan losses</b>	<b>80,408</b>	<b>89,846</b>	<b>184,687</b>	<b>181,444</b>
<b>Noninterest Income</b>				
Loan-related fees	3,345	3,391	6,643	6,219
Gain from sale of investment securities	-	-	543	-
Miscellaneous income, net	1,759	1,656	5,057	3,458
<b>Total noninterest income</b>	<b>5,104</b>	<b>5,047</b>	<b>12,243</b>	<b>9,677</b>
<b>Noninterest Expense</b>				
Salaries and employee benefits	20,367	18,800	44,280	40,689
Occupancy and equipment	3,162	2,805	6,074	5,291
Insurance Fund premiums	5,008	3,891	10,251	7,786
Gains (losses) on other property owned, net	28	(378)	102	(185)
Other operating expenses	12,308	10,844	24,419	21,918
<b>Total noninterest expense</b>	<b>40,873</b>	<b>35,962</b>	<b>85,126</b>	<b>75,499</b>
Income before provision for income taxes	44,639	58,931	111,804	115,622
Provision for income taxes	338	387	450	509
<b>Net Income</b>	<b>\$ 44,301</b>	<b>\$ 58,544</b>	<b>\$ 111,354</b>	<b>\$ 115,113</b>

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

## Combined Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2005	\$ 203,569	\$ 73,642	\$ 32,327	\$ 1,692,534	\$ (46,977)	\$ 1,955,095
Comprehensive income						
Net income	-	-	-	115,113	-	115,113
Unrealized net losses on investment securities	-	-	-	-	(14,570)	(14,570)
Net change in unrealized gains on cash flow derivatives	-	-	-	-	(952)	(952)
Total comprehensive income	-	-	-	115,113	(15,522)	99,591
Capital stock/participation certificates issued	-	12,252	-	-	-	12,252
Capital stock/participation certificates and allocated retained earnings retired	(4)	(28,317)	-	-	-	(28,321)
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(5,385)	-	(5,385)
Members' equity	-	-	(2,058)	2,058	-	-
Balance at June 30, 2006	<u>\$ 203,565</u>	<u>\$ 57,577</u>	<u>\$ 30,269</u>	<u>\$ 1,796,759</u>	<u>\$ (62,499)</u>	<u>\$ 2,025,671</u>
Balance at December 31, 2006	\$ 203,565	\$ 59,068	\$ 83,705	\$ 1,792,723	\$ (26,401)	\$ 2,112,660
Comprehensive income						
Net income	-	-	-	111,354	-	111,354
Unrealized net losses on investment securities	-	-	-	-	(1,883)	(1,883)
Total comprehensive income	-	-	-	111,354	(1,883)	109,471
Capital stock/participation certificates issued	-	6,724	-	-	-	6,724
Capital stock/participation certificates and allocated retained earnings retired	(395)	(4,826)	(108)	-	-	(5,329)
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(12,647)	-	(12,647)
Members' equity	-	-	6,038	(6,038)	-	-
Balance at June 30, 2007	<u>\$ 203,170</u>	<u>\$ 60,966</u>	<u>\$ 89,635</u>	<u>\$ 1,877,831</u>	<u>\$ (28,284)</u>	<u>\$ 2,203,318</u>

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

**Combined Statements of Cash Flows**

(unaudited)

(dollars in thousands)	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Operating activities</b>		
Net income	\$ 111,354	\$ 115,113
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	27,020	4,904
(Negative provision) provision for losses on other property owned	(18)	536
Depreciation and amortization on premises and equipment	2,650	2,487
Accretion of net discount on loans	(589)	(370)
Amortization and accretion on debt instruments	(484)	(703)
Amortization of net premium on investment securities	(2,148)	(5,982)
Gain of sale of investments	(543)	-
Losses (gains) from sales of other property owned, net	61	(355)
Gains from sales of premises and equipment	(76)	(3,129)
Increase in accrued interest receivable	(36,247)	(37,226)
Increase in other assets	(3,698)	(1,871)
Increase in accrued interest payable	16,409	20,698
Decrease in other liabilities	(14,809)	(17,218)
Net cash provided by operating activities	<u>98,882</u>	<u>76,884</u>
<b>Investing activities</b>		
Net increase in federal funds sold and securities purchased under resale agreements	(1,235)	(83,968)
Investment securities		
Purchases	(2,158,406)	(3,084,247)
Proceeds from maturities, calls and prepayments	2,201,849	2,796,458
Proceeds from sales	83,163	-
Increase in loans, net	(953,820)	(1,002,251)
Proceeds from sale of loans	300,000	100,000
Proceeds from sales of premises and equipment	2,100	1,895
Expenditures for premises and equipment	(5,741)	(2,747)
Net cash used in investing activities	<u>(532,090)</u>	<u>(1,274,860)</u>
<b>Financing activities</b>		
Bonds and notes issued	13,193,989	12,784,415
Bonds and notes retired	(12,714,729)	(11,571,104)
Increase in advanced conditional payments	495	9,852
Capital stock and participation certificates issued	6,724	12,252
Capital stock and participation certificates retired	(5,233)	(28,321)
Cash dividends on preferred stock	(7,561)	(7,561)
Cash patronage distributions paid	(69,808)	(5,385)
Net cash provided by financing activities	<u>403,877</u>	<u>1,194,148</u>
Net decrease in cash	(29,331)	(3,828)
Cash at beginning of year	60,170	51,847
Cash at end of quarter	<u>\$ 30,839</u>	<u>\$ 48,019</u>
<b>Supplemental schedule of noncash investing and financing activities</b>		
Financed sales of other property owned	\$ 1,376	\$ 3,126
Loan assets transferred to other property owned	1,620	681
Unrealized net losses on investment securities	(1,883)	(14,570)
Cash dividends or patronage distributions payable	3,008	1,048
<b>Supplemental schedule of noncash changes in fair value related to hedging activities</b>		
Decrease in bonds and notes	\$ (6,831)	\$ (2,285)
<b>Supplemental information</b>		
Cash paid for:		
Interest	\$ 348,142	\$ 255,642
Income taxes	315	186

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

## Notes to Combined Financial Statements

*Unaudited (dollar amounts in thousands unless otherwise noted)*

### NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying combined financial statements (financial statements) include the accounts of the Farm Credit Bank of Texas (bank) and the accounts of the Agricultural Credit Associations (ACAs) and Federal Land Credit Associations (FLCAs) of the Tenth Farm Credit District (district) of the Farm Credit System (System). The ACAs and FLCAs are collectively referred to as associations. The financial statements also reflect the investments in and allocated earnings of the service organizations in which the bank has a partial ownership interest. All significant transactions and balances between the bank and the associations have been eliminated in combination.

The significant accounting policies followed and the financial condition and results of operations of the combined bank and associations as of and for the year ended December 31, 2006, are contained in the 2006 Annual Report to stockholders (Annual Report). These unaudited second quarter 2007 financial statements should be read in conjunction with the Annual Report.

The accompanying financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations of the district, and conform to generally accepted accounting principles. The preparation of these financial statements requires the use of management's estimates. The results of operations for any interim period are not necessarily indicative of the results to be expected for the entire year. Certain amounts in prior years' combined financial statements have been reclassified to conform with the current year's presentation.

### NOTE 2 — ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 13,969	\$ 9,533
Provision for loan losses	27,020	4,904
Loans charged off	(16,038)	(4,152)
Recoveries	350	786
Balance at end of period	<u>\$ 25,301</u>	<u>\$ 11,071</u>

### NOTE 3 — COMMITMENTS AND CONTINGENT LIABILITIES

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 the other System banks. Total consolidated bank and systemwide obligations of the System at June 30, 2007, were approximately \$140.4 billion.

Other actions are pending against the bank and associations in which claims for monetary damage 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 combined financial positions or results of operations of the bank and associations.

#### **NOTE 4 — EMPLOYEE BENEFIT PLANS**

The multi-employer structure of certain of the district's retirement and benefit plans results in the recording of these plans only upon combination. The following table summarizes the components of net periodic benefit costs for the six months ended June 30:

	Pension Benefits		Other Benefits	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Service cost	\$ 2,605	\$ 2,652	\$ 617	\$ 702
Interest cost	6,774	5,720	1,136	1,002
Expected return on plan assets	(6,124)	(5,722)	-	-
Amortization of prior service costs	572	525	(922)	(960)
Amortization of net loss	1,585	2,143	36	131
Net periodic benefit cost	<u>\$ 5,412</u>	<u>\$ 5,318</u>	<u>\$ 867</u>	<u>\$ 875</u>

As of June 30, 2007, \$6.1 million of contributions has been made for pension benefits. The district presently anticipates no additional contributions to fund its pension plan in 2007.

#### **NOTE 5 — INCOME TAXES**

Upon adoption of the Financial Accounting Standards Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," the bank and its affiliated associations recognized no additional liability for income taxes or related penalties or interest with regard to uncertain tax positions.

## NOTE 6 — BANK-ONLY FINANCIAL DATA

Condensed financial information for the bank follows. All significant transactions and balances between the bank and associations are eliminated in combination.

<b>Balance sheet data</b>	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Cash	\$ 6,442	\$ 14,165
Federal funds sold and securities purchased under resale agreements	90,464	89,229
Investment securities	2,546,443	2,672,242
Loans	10,690,545	10,055,428
Less allowance for loan losses	640	142
Net loans	10,689,905	10,055,286
Accrued interest receivable	71,914	63,967
Premises and equipment, net	2,612	2,286
Other assets	21,780	18,585
Total assets	<u>\$ 13,429,560</u>	<u>\$ 12,915,760</u>
 Bonds and notes	 \$ 12,592,728	 \$ 12,120,783
Accrued interest payable	111,732	96,550
Other liabilities	38,628	34,206
Total liabilities	12,743,088	12,251,539
Preferred stock	200,000	200,000
Capital stock	161,421	161,421
Retained earnings	348,404	324,270
Accumulated other comprehensive loss	(23,353)	(21,470)
Total shareholders' equity	686,472	664,221
Total liabilities and shareholders' equity	<u>\$ 13,429,560</u>	<u>\$ 12,915,760</u>
<b>Statement of income data</b>	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Interest income	\$ 372,632	\$ 293,350
Interest expense	322,618	248,789
Net interest income	50,014	44,561
Provision for loan losses	400	2,578
Net interest income after provision		
for loan losses	49,614	41,983
Noninterest income	10,561	8,134
Noninterest expense	24,423	20,462
Net income	<u>\$ 35,752</u>	<u>\$ 29,655</u>