



STRENGTH THROUGH DIVERSITY

2008 SECOND QUARTER REPORT
FARM CREDIT BANK OF TEXAS
JUNE 30, 2008

SECOND QUARTER 2008

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Management's Discussion and Analysis of Financial Condition and Results of Operations

(dollars in thousands, except as noted)

The following discussion reviews the financial condition and results of operations of the Farm Credit Bank of Texas (bank) for the three and six months ended June 30, 2008. These comments should be read in conjunction with the accompanying financial statements and footnotes, along with the 2007 Annual Report to shareholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

The bank is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration promulgated thereunder.

The United States is currently served by four Farm Credit Banks (FCBs), each of which has specific regional lending authority within a chartered territory (or district), and by one Agricultural Credit Bank (ACB), which has the lending authority of an FCB within its chartered territory and limited nationwide lending authority. The FCBs and the ACB are collectively referred to as "System banks." The primary purpose of the FCBs is to serve as a source of funding for System associations within its district. The System associations make loans to or for the benefit of eligible borrowers for qualified purposes.

The bank and its related associations collectively are referred to as the Tenth Farm Credit District (district). At June 30, 2008, the bank served 20 district associations and certain other financing institutions.

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended June 30, 2008, was \$22,198, an increase of \$3,969, or 21.8 percent, from the quarter ended June 30, 2007. The \$3,969 increase in net income for the second quarter of 2008 was due to a \$4,381 increase in net interest income and a \$2,986 increase in noninterest income, offset by a \$2,194 increase in provision for loan losses and a \$1,204 increase in noninterest expense.

Net income for the six months ended June 30, 2008, was \$43,217, an increase of \$7,465, or 20.9 percent, over the same period of 2007. The increase in net income for the six months ended June 30, 2008, consisted of a \$7,452 increase in net interest income and a \$6,674 increase in noninterest income, offset by a \$4,347 increase in provision for loan losses and a \$2,314 increase in noninterest expense.

Net Interest Income

Net interest income for the three months ended June 30, 2008, was \$29,386, an increase of \$4,381, or 17.5 percent, from the three months ended June 30, 2007. The increase in net interest income for the quarter ended June 30, 2008, was attributable to an increase of \$576.4 million in the bank's average earning assets and a 13-basis-point increase in the bank's interest rate spread.

Net interest income for the six months ended June 30, 2008, was \$57,466, an increase of \$7,452, or 14.9 percent, over the same period of 2007. The increase in net interest income was attributable to a volume increase of \$494.7 million in the bank's average earning assets and an 11-basis-point increase in the bank's interest rate spread. The growth in interest-earning assets for the three and six months ended June 30, 2008, was due primarily to increases in the bank's participations portfolio.

Provision for Loan Losses

The bank's provision for loan losses for the quarter ended June 30, 2008, was \$2,594, representing an increase of \$2,194 over the \$400 provision for the second quarter of 2007. Provision for loan losses for the six months ended June 30, 2008, was \$4,747, reflecting an increase of \$4,347 over the same period of 2007. While overall credit quality has remained high through the second quarter of 2008, the bank recorded specific provisions on two participation loans that were in nonaccrual status. The allowance at June 30, 2008, was considered adequate by management to absorb probable losses inherent to its loan portfolio.

Noninterest Income

Noninterest income for the quarter ended June 30, 2008, was \$7,577, reflecting an increase of \$2,986, or 65.0 percent, over the same period of 2007. Noninterest income for the six months ended June 30, 2008, was \$17,235, reflecting an increase of \$6,674, or 63.2 percent, over the same period of 2007. The increase for the second quarter of 2008 over the same period of 2007 was due mainly to a \$2,233 increase in patronage income from another Farm Credit System entity, a \$307 increase in services billed to associations, a \$298 increase in fees for loan-related services, and a \$148 increase in all other noninterest income items, collectively.

The \$6,674 increase in noninterest income for the six months ended June 30, 2008, compared to the same period of 2007 was primarily the result of a \$6,232 increase in patronage income from another Farm Credit System entity, a \$585 increase in fees for loan-related services, a \$370 increase in services billed to associations, and a \$30 increase in all other noninterest income items, collectively, offset by a \$543 decrease in gain on sale of investments.

Noninterest Expense

Noninterest expense for the three and six months ended June 30, 2008, was \$12,171 and \$26,737, respectively, reflecting an increase of \$1,204 and \$2,314, respectively, over the same periods of 2007. The increase for the second quarter is primarily attributable to a \$908 increase in salaries and employee benefits, a \$302 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), a \$218 increase in other operating expenses, and a \$6 decrease in gains on other property owned, net of a \$230 decrease in occupancy and equipment expenses. The \$908 increase in salaries and employee benefits was primarily due to a \$533 increase in compensation and related payroll taxes, a \$364 increase in pension and retirement expenses, and an \$11 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 \$62 increase in professional and contract services, a \$46 increase in examination fees, a \$44 increase in Funding Corp. assessment fees, a \$36 increase in advertising and member relations expenses, and a \$30 increase in all other operating expenses, collectively. The \$230 decrease in occupancy and equipment expenses is due mainly to the recognition of retroactive building lease-related operating and tax expenses for the prior year.

The \$2,314 increase in noninterest expense for the six months ended June 30, 2008, compared to the same period of 2007 was due mainly to a \$1,966 increase in salaries and employee benefits, a \$415 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), a \$147 increase in other operating expenses, and a \$1 decrease in gains on other property owned, net of a \$215 decrease in occupancy and equipment expenses. The \$1,966 increase in salaries and employee benefits was primarily due to a \$1,167 increase in compensation and related payroll taxes, a \$761 increase in pension and retirement expenses, and a \$38 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 \$119 increase in communication expenses, a \$92 increase in examination fees, and a \$22 increase in all other operating expenses, collectively, offset by an \$86 decrease in advertising and member relations expenses. The \$215 decrease in occupancy and equipment expenses is due mainly to the recognition of retroactive building lease-related operating and tax expenses for the prior year.

Key results of operations comparisons:

	Annualized for the Six Months Ended 6/30/2008	Annualized for the Six Months Ended 6/30/2007
Return on average assets	0.63%	0.54%
Return on average shareholders' equity	11.63%	10.52%
Net interest income as a percentage of average earning assets	0.84%	0.76%
Charge-offs, net of recoveries, to average loans	<0.01	<0.01
Operating expenses as a percentage of net interest income and noninterest income	35.81%	40.34%
Operating expenses as a percentage of average earning assets	0.39%	0.37%

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at June 30, 2008, was \$11,619,422, reflecting an increase of \$753,431, or 6.9 percent, compared to \$10,865,991 at December 31, 2007. The changes are net of the effect of the sale of a total of \$400 million in participations in its direct notes receivable from associations to another Farm Credit entity during the first six months of 2008. At June 30, 2008, the cumulative total of participations in association loans sold was \$3.1 billion. The increase in the loan portfolio is mainly attributable to increases in the bank's capital markets loan portfolio and to a lesser extent, to growth in the bank's direct loans to associations and other financing institutions. Overall credit quality remained strong, with loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" at 99.7 percent of total loans and accrued interest at June 30, 2008, and December 31, 2007.

Comparative balances of high-risk assets follow:

	June 30, 2008	Increase (Decrease)		December 31, 2007
		\$	%	
Nonaccrual loans	\$ 23,763	\$ (160)	(0.67) %	\$ 23,923
Formally restructured loans	713	(2)	(0.28)	715
Loans 90 days past due and still accruing interest	-	(9,999)	(100.00)	9,999
Total impaired loans	\$ 24,476	\$ (10,161)	(29.34)	\$ 34,637

The \$9,999 decrease in loans 90 days or more past due and still accruing interest is due to one participation loan which repaid in full during the first quarter of 2008. Impaired loans, consisting of nonaccrual loans, formally restructured loans and loans 90 days or more past due and still accruing interest, constituted 0.2 percent of gross loans at June 30, 2008, and 0.3 percent of gross loans at December 31, 2007.

At June 30, 2008, the allowance for loan losses was \$6,036, equating to 0.05 percent of total loans outstanding, and 0.20 percent of capital markets participation loans outstanding, and was considered by management to be adequate to absorb estimated losses inherent in the loan portfolio at that date.

Liquidity and Funding Sources

As of June 30, 2008, the bank exceeded the minimum permanent capital, core surplus, total surplus, and net collateral ratio requirements under Farm Credit Administration regulations. At June 30, 2008, the bank's permanent capital ratio was 12.81 percent, core surplus was 5.95 percent, total surplus was 10.00 percent, and the net collateral ratio was 105.16 percent. Cash and investment securities totaled \$2,681,169, or 18.6 percent, of total assets at June 30, 2008, compared to \$2,553,101, or 18.9 percent, at December 31, 2007, reflecting an increase of \$128,068, or 5.0 percent. Interest-bearing liabilities, consisting of bonds and notes, increased by \$873,881, or 6.9 percent, in order to fund the increases in earning assets previously discussed.

The bank's investments included an available-for-sale portfolio with a fair market value of \$2.6 billion and a held-to-maturity portfolio recorded at an amortized cost of \$53.0 million at June 30, 2008. The held-to-maturity portfolio consisted of mission-related rural housing mortgage-backed securities that had a fair value of \$52.3 million. The bank's available-for-sale portfolio includes \$127.3 million in asset-backed securities, including \$22.0 million in securitizations of Sallie Mae loans and \$105.3 million of sub-prime mortgage, asset-backed securities. Due to the economic conditions currently affecting that market, the bank reviews internally the investments in question, and consults with outside analysts. Of the sub-prime asset-backed securities, \$103.3 million were rated Aaa and AAA by Moody's and Standard and Poor's, respectively. One \$2.1 million securitization of sub-prime mortgages was downgraded to Baa3 and BB by Moody's and Standard and Poor's, respectively. The FCA approved the bank's plan of divestiture for this downgraded investment, which indicated the bank's desire to continue to hold the investment. Subsequent changes in market or credit conditions could change these evaluations. The bank continues to monitor these investments. Asset-backed securities represent 4.9 percent of the bank's investment portfolio.

Capital Resources

Total shareholders' equity at June 30, 2008, totaled \$749,615, an increase of \$21,014 from December 31, 2007. This increase is the result of net income of \$43,217 for the six months ended June 30, 2008, an adjustment to accumulated other comprehensive income of \$47, and a net increase in capital stock of \$1, offset by dividends paid on preferred stock totaling \$7,561, an increase in unrealized net losses on investment securities totaling \$6,090, a \$4,410 unrealized loss on cash flow derivatives, an adjustment to retained earnings of \$406 resulting from the effects of an accounting change regarding the measurement date of postretirement benefits plans pursuant to FASB Statement No. 158, and patronage declared of \$3,784.

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, and to a lesser extent, to changes in the market value of sub-prime asset-backed

securities. The bank considers all of the unrealized losses on its investment securities to be temporary in nature, and has both the ability and the intent to recover substantially all of its investment in the securities.

Key financial condition comparisons:

	<u>June 30, 2008</u>	<u>December 31, 2007</u>
Total shareholders' equity to total assets	5.20%	5.39%
Total liabilities to shareholders' equity	18.21:1	17.56:1
Allowance for loan losses to total loans	0.05%	0.01%

OTHER

In June 2008, the board of the FCSIC voted to set premiums at 15 basis points on adjusted insured debt outstanding for the third quarter of 2008 and 18 basis points on adjusted insured debt outstanding for the fourth quarter of 2008. In addition, there will be a 10-basis-point premium on the average principal outstanding for nonaccrual loans and on the average amount outstanding for any other-than-temporarily impaired investments. The change in premiums to the new rates and bases are effective July 1, 2008.

The undersigned certify that we have reviewed the June 30, 2008, quarterly report of the Farm Credit Bank of Texas, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.



Larry R. Doyle
Chief Executive Officer



Ralph W. Cortese
Chairman of the Board



Thomas W. Hill
Chief Financial Officer

July 31, 2008

Balance Sheets

(dollars in thousands)	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Cash	\$ 14,847	\$ 16,600
Federal funds sold and securities purchased under resale agreements	141,879	125,502
Investment securities	2,524,443	2,410,999
Loans	11,619,422	10,865,991
Less allowance for loan losses	6,036	1,065
Net loans	11,613,386	10,864,926
Accrued interest receivable	61,536	66,789
Premises and equipment, net	4,652	2,719
Other assets	41,675	33,243
Total assets	\$ 14,402,418	\$ 13,520,778
Liabilities and shareholders' equity		
Liabilities		
Bonds and notes, net	\$ 13,497,896	\$ 12,624,015
Accrued interest payable	109,585	110,188
Other liabilities	45,322	57,974
Total liabilities	13,652,803	12,792,177
Commitments and contingent liabilities (Note 3)		
Shareholders' equity		
Preferred stock, net	200,000	200,000
Capital stock	198,865	198,864
Allocated retained earnings	5,195	5,196
Unallocated retained earnings	360,665	329,198
Accumulated other comprehensive loss	(15,110)	(4,657)
Total shareholders' equity	749,615	728,601
Total liabilities and shareholders' equity	\$ 14,402,418	\$ 13,520,778

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

Statements of Income

(unaudited)

(dollars in thousands)	Quarter Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Interest Income				
Investment securities	\$ 26,564	\$ 32,895	\$ 55,074	\$ 67,621
Loans	133,983	155,798	278,495	305,011
Total interest income	160,547	188,693	333,569	372,632
Interest Expense				
Bonds and notes	131,161	163,688	276,103	322,618
Net interest income	29,386	25,005	57,466	50,014
Provision for loan losses	2,594	400	4,747	400
Net interest income after provision for loan losses	26,792	24,605	52,719	49,614
Noninterest Income				
Fees for services to associations	2,476	2,169	4,687	4,317
Loan-related fees	1,422	1,124	3,012	2,427
Gain from sale of investment securities	-	-	-	543
Miscellaneous income, net	3,679	1,298	9,536	3,274
Total noninterest income	7,577	4,591	17,235	10,561
Noninterest Expense				
Salaries and employee benefits	5,658	4,750	14,370	12,404
Occupancy and equipment	1,184	1,414	2,379	2,594
Insurance Fund premiums	1,194	892	2,264	1,849
Gains on other property owned, net	(6)	(12)	(11)	(12)
Other operating expenses	4,141	3,923	7,735	7,588
Total noninterest expense	12,171	10,967	26,737	24,423
Net Income	\$ 22,198	\$ 18,229	\$ 43,217	\$ 35,752

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

Statements of Changes in Shareholders' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock	Allocated Retained Earnings	Unallocated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2006	\$ 200,000	\$ 161,421	\$ 6,194	\$ 318,076	\$ (21,470)	\$ 664,221
Comprehensive income						
Net income	-	-	-	35,752	-	35,752
Unrealized net losses on investment securities	-	-	-	-	(1,883)	(1,883)
Total comprehensive income	-	-	-	35,752	(1,883)	33,869
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(4,057)	-	(4,057)
Shareholders' equity	-	-	3	(3)	-	-
Balance at June 30, 2007	<u>\$ 200,000</u>	<u>\$ 161,421</u>	<u>\$ 6,197</u>	<u>\$ 342,207</u>	<u>\$ (23,353)</u>	<u>\$ 686,472</u>
Balance at December 31, 2007	\$ 200,000	\$ 198,864	\$ 5,196	\$ 329,198	\$ (4,657)	\$ 728,601
Comprehensive income						
Net income	-	-	-	43,217	-	43,217
Amortization of costs included in net periodic pension costs	-	-	-	-	47	47
Unrealized net losses on investment securities	-	-	-	-	(6,090)	(6,090)
Unrealized net losses on cash flow derivatives	-	-	-	-	(4,410)	(4,410)
Total comprehensive income	-	-	-	43,217	(10,453)	32,764
Effects of accounting change regarding measurement date of postretirement benefits plans pursuant to FASB Statement No. 158	-	-	-	(406)	-	(406)
Capital stock issued	-	1	-	-	-	1
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(3,784)	-	(3,784)
Shareholders' equity	-	-	(1)	1	-	-
Balance at June 30, 2008	<u>\$ 200,000</u>	<u>\$ 198,865</u>	<u>\$ 5,195</u>	<u>\$ 360,665</u>	<u>\$ (15,110)</u>	<u>\$ 749,615</u>

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

Statements of Cash Flows

(unaudited)

(dollars in thousands)	Six Months Ended June 30,	
	2008	2007
Operating activities		
Net income	\$ 43,217	\$ 35,752
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	4,747	400
Depreciation and amortization on premises and equipment	515	448
Accretion of net discount on loans	(28)	(208)
Amortization and accretion on debt instruments	(1,172)	(484)
Amortization of net premium on investment securities	(421)	(2,148)
Gain on sale of investment securities	-	(543)
Gains from sales of other property owned, net	(11)	(12)
(Gains) losses from sales of premises and equipment	(2)	2
Decrease (increase) in accrued interest receivable	5,253	(7,947)
Increase in other assets	(9,722)	(4,160)
(Decrease) increase in accrued interest payable	(603)	15,182
(Decrease) increase in other liabilities	(4,874)	4,108
Net cash provided by operating activities	36,899	40,390
Investing activities		
Net increase in federal funds sold and securities purchased under resale agreements	(16,377)	(1,235)
Investment securities		
Purchases	(1,557,474)	(2,158,406)
Proceeds from maturities, calls and prepayments	1,438,361	2,201,849
Proceeds from sales	-	83,163
Increase in loans, net	(1,157,463)	(934,799)
Proceeds from sale of loans	400,000	300,000
Proceeds from sales of premises and equipment	2	108
Expenditures for premises and equipment	(2,448)	(884)
Net cash used in investing activities	(895,399)	(510,204)
Financing activities		
Bonds and notes issued	24,122,324	13,193,989
Bonds and notes retired	(23,246,431)	(12,714,729)
Capital stock issued	1	-
Cash dividends on preferred stock	(7,561)	(7,561)
Cash patronage distributions paid	(11,586)	(9,608)
Net cash provided by financing activities	856,747	462,091
Net decrease in cash	(1,753)	(7,723)
Cash at beginning of year	16,600	14,165
Cash at end of quarter	\$ 14,847	\$ 6,442
Supplemental schedule of noncash investing and financing activities		
Net increase in unrealized losses on investment securities	\$ (6,090)	\$ (1,883)
Supplemental schedule of noncash changes in fair value related to hedging activities		
Decrease in bonds and notes	\$ (840)	\$ (6,831)
Supplemental information		
Interest paid	\$ 276,706	\$ 307,436

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

Notes to Financial Statements

Unaudited (dollar amounts in thousands unless otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the accounts of the Farm Credit Bank of Texas (bank). The significant accounting policies followed and the financial condition and results of operations of the bank as of and for the year ended December 31, 2007, are contained in the 2007 Annual Report to shareholders (Annual Report). These unaudited second quarter 2008 financial statements should be read in conjunction with the Annual Report.

In December 2007, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 141R, "Business Combinations" (SFAS No. 141R). SFAS No. 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS No. 141R should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. The bank and its related associations are still evaluating the provisions of the standard, but believe that its adoption will significantly impact its accounting for acquisitions that occur in 2009 and beyond.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand:

- a. How and why an entity uses derivative instruments
- b. How derivative instruments and related hedged items are accounted for under this statement and related interpretations
- c. How derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows.

This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The bank is currently evaluating the impact of adoption on its financial statement disclosures.

Effective January 1, 2008, the bank adopted SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

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

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

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, and highly structured or long-term derivative contracts.

The accompanying financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations of the bank, 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.

The bank is part of the Tenth Farm Credit District (district), which is part of the federally chartered Farm Credit System (System). The bank provides funding to district associations, which, in turn, provide credit to their borrower-shareholders. At June 30, 2008, the bank served 20 district associations and certain other financing institutions.

NOTE 2 — ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	Six Months Ended June 30,	
	2008	2007
Balance at beginning of period	\$ 1,065	\$ 142
Provision for loan losses	4,747	400
Recoveries	224	98
Balance at end of period	<u>\$ 6,036</u>	<u>\$ 640</u>

At June 30, 2008, impaired loans of \$23.3 million had a related specific allowance of \$5.8 million, while the remaining \$1.2 million of impaired loans had no related specific allowance.

The average recorded investment in impaired loans for the six months ended June 30, 2008, was \$24.8 million. The bank recognized interest income of \$77 on impaired loans during the six months ended June 30, 2008.

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, 2008, were approximately \$175.4 billion.

In early February 2008, the bank was named as a counter-defendant in a lawsuit involving a lending matter between an association in the district and a borrower group. In April 2008, the bank was dismissed without prejudice from the lawsuit.

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 4 — FAIR VALUE MEASUREMENTS

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 1 – Organization and Significant Accounting Policies for additional information.

There was no financial statement impact resulting from the adoption of SFAS No. 157 by the bank. Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at June 30, 2008				
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Total			
Available-for-sale investment securities	\$ 2,613,336	\$ -	\$ 2,396,968	\$ 216,368
Derivatives, net	1,606	-	1,606	-
Total	<u>\$ 2,614,942</u>	<u>\$ -</u>	<u>\$ 2,398,574</u>	<u>\$ 216,368</u>

The following table represents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period from January 1, 2008, to June 30, 2008.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3):

Available-for-sale investment securities:	
Balance at December 31, 2007	\$ 273,231
Net losses included in other comprehensive income	(2,035)
Purchases, issuances and settlements	(71,743)
Transfers into Level 3	16,915
Balance at June 30, 2008	<u>\$ 216,368</u>

The net losses included in other comprehensive income in the above table are all on securities held at June 30, 2008.

Valuation Techniques

As more fully discussed in Note 1 – Organization and Summary of Significant Accounting Policies, SFAS No. 157 establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the bank's assets and liabilities:

Investment Securities

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

Derivatives

The bank's derivative positions are valued using internally developed models that use as their basis readily observable market parameters and are classified within Level 2 of the valuation hierarchy. Such derivatives include basic interest rate swaps.

NOTE 5 — EMPLOYEE BENEFIT PLANS

The following table summarizes the components of net periodic benefit costs for the bank's supplemental defined benefit pension plan and for the bank's other postretirement benefit costs for the six months ended June 30:

	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Service cost	\$ 203	\$ 184	\$ 84	\$ 95
Interest cost	273	213	207	192
Amortization of prior service costs	177	331	(153)	(170)
Amortization of net loss	25	-	(3)	(2)
Net periodic benefit cost	<u>\$ 678</u>	<u>\$ 728</u>	<u>\$ 135</u>	<u>\$ 115</u>

The bank recorded a \$406 charge against retained earnings pursuant to a change in the measurement date of postretirement benefits from September 30 to December 31 in accordance with SFAS No. 158.

The structure of the district's defined benefit pension plan is characterized as multi-employer, since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations).

NOTE 6 — COMBINED ASSOCIATION FINANCIAL DATA

Condensed financial information for the 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.

Balance sheet data	June 30, 2008	December 31, 2007
Cash	\$ 21,432	\$ 39,103
Investment securities	19,376	-
Loans	13,090,578	12,300,861
Less allowance for loan losses	32,780	23,430
Net loans	13,057,798	12,277,431
Accrued interest receivable	195,808	197,117
Other property owned, net	638	1,817
Other assets	273,485	262,802
Total assets	<u>\$ 13,568,537</u>	<u>\$ 12,778,270</u>
Bonds and notes	\$ 11,499,157	\$ 10,747,261
Other liabilities	188,521	252,204
Total liabilities	11,687,678	10,999,465
Capital stock and participation certificates	64,412	63,267
Retained earnings	1,806,594	1,705,238
Accumulated other comprehensive income	9,853	10,300
Total members' equity	1,880,859	1,778,805
Total liabilities and members' equity	<u>\$ 13,568,537</u>	<u>\$ 12,778,270</u>

Statement of income data	Six Months Ended June 30,	
	2008	2007
Interest income	\$ 424,116	\$ 427,159
Interest expense	251,138	265,484
Net interest income	172,978	161,675
Provision for loan losses	10,326	26,620
Net interest income after provision		
for loan losses	162,652	135,055
Noninterest income	39,680	29,845
Noninterest expense	85,507	73,747
Provision for income taxes	217	450
Net income	<u>\$ 116,608</u>	<u>\$ 90,703</u>

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