STRENGTH THROUGH DIVERSITY

2008 THIRD QUARTER REPORT
FARM CREDIT BANK OF TEXAS
SEPTEMBER 30, 2008

THIRD 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 nine months ended September 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 September 30, 2008, the bank served 20 district associations and certain other financing institutions.

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended September 30, 2008, was $19,148, an increase of $308, or 1.6 percent, from the quarter ended September 30, 2007. The $308 increase in net income for the third quarter of 2008 was due to a $5,590 increase in net interest income and a $2,923 increase in noninterest income, offset by a $6,280 increase in provision for loan losses and a $1,925 increase in noninterest expense.

Net income for the nine months ended September 30, 2008, was $62,635, an increase of $7,773, or 14.2 percent, over the same period of 2007. The increase in net income for the nine months ended September 30, 2008, consisted of a $13,042 increase in net interest income and a $9,597 increase in noninterest income, offset by a $10,627 increase in provision for loan losses and a $4,239 increase in noninterest expense.

Net Interest Income

Net interest income for the three months ended September 30, 2008, was $30,375, an increase of $5,590, or 22.6 percent, from the three months ended September 30, 2007. The increase in net interest income for the quarter ended September 30, 2008, was attributable to an increase of $628.4 million in the bank's average earning assets and an 18-basis-point increase in the bank's interest rate spread.

Net interest income for the nine months ended September 30, 2008, was $87,841, an increase of $13,042, or 17.4 percent, over the same period of 2007. The increase in net interest income was attributable to a volume increase of $539.2 million in the bank's average earning assets and a 13-basis-point increase in the bank's interest rate spread. The growth in interest-earning assets for the three and nine months ended September 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 September 30, 2008, was $5,998, representing an increase of $6,280 over the $282 negative provision for the third quarter of 2007. Provision for loan losses for the nine months ended September 30, 2008, was $10,745, reflecting an increase of $10,627 over the same period of 2007. While overall credit quality has remained strong through the third quarter of 2008, the bank recorded specific provisions on participation loans to five borrowers that were in nonaccrual status. The allowance at September 30, 2008, was considered adequate by management to absorb probable losses inherent to its loan portfolio.

Noninterest Income

Noninterest income for the quarter ended September 30, 2008, was $7,519, reflecting an increase of $2,923, or 63.6 percent, over the same period of 2007. Noninterest income for the nine months ended September 30, 2008, was $24,754, reflecting an increase of $9,597, or 63.3 percent, over the same period of 2007. The increase for the third quarter of 2008 over the same period of 2007 was due mainly to a $2,282 increase in patronage income from another Farm Credit System entity, a $272 increase in fees for loan-related services, a $75 increase in services billed to associations, and a $294 increase in all other noninterest income items, collectively.

The $9,597 increase in noninterest income for the nine months ended September 30, 2008, compared to the same period of 2007 was primarily the result of a $8,514 increase in patronage income from another Farm Credit System entity, an $857 increase in fees for loan-related services, a $445 increase in services billed to associations, and a $324 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 nine months ended September 30, 2008, was $12,748 and $39,485, respectively, reflecting an increase of $1,925 and $4,239, respectively, over the same periods of 2007. The increase for the third quarter is primarily attributable to a $1,007 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund), a $511 increase in salaries and employee benefits, a $258 increase in other operating expenses, and a $154 increase in occupancy and equipment expenses, net of a $5 increase in gains on other property owned. The $1,007 increase in premiums paid to the Insurance Fund was primarily due to a change in the premium base effective July 1, 2008, from loans to Systemwide debt outstanding. The $511 increase in salaries and employee benefits was primarily due to a $367 increase in pension and retirement expenses and a $138 increase in compensation and related payroll taxes and a $6 increase in other benefits. Compensation increased due to increases in the number of employees and increases in compensation rates. Other operating expenses increased due to a $192 increase in communications expenses, a $57 increase in advertising and member relations expenses, a $46 increase in examination fees, a $36 increase in Federal Farm Credit Banks Funding Corporation (Funding Corporation) assessment fees, and a $61 increase in all other operating expenses, collectively, offset by a $134 decrease in professional and contract services. The $154 increase in occupancy and equipment expenses is due mainly to a $148 increase in computer equipment expenses and $6 increase in other occupancy and equipment expenses.

The $4,239 increase in noninterest expense for the nine months ended September 30, 2008, compared to the same period of 2007 was due mainly to a $2,477 increase in salaries and employee benefits, a $1,422 increase in premiums to the FCSIC, and a $405 increase in other operating expenses, net of a $61 decrease in occupancy and equipment expenses and a $4 increase in gains on other property owned.

The $2,477 increase in salaries and employee benefits was primarily due to a $1,305 increase in compensation and related payroll taxes, a $1,127 increase in pension and retirement expenses, and a $45 increase in other benefits. Compensation increased due to increases in the number of employees and increases in compensation rates. The $1,422 increase in premiums paid to the Insurance Fund was primarily due to a change in the premium base effective July 1, 2008, from loans to Systemwide debt outstanding and to an increase in the loans on which premiums were based during the first six months of 2008. Other operating expenses increased due to a $312 increase in communication expenses, a $138 increase in examination fees, a $74 increase in Funding Corporation assessment fees, and a $50 increase in all other operating expenses, collectively, offset by a $169 decrease in professional and contract services.

Key results of operations comparisons:

	Annualized for the Nine Months Ended 9/30/2008	Annualized for the Nine Months Ended 9/30/2007
Return on average assets	**0.60%**	0.54%
Return on average shareholders' equity	**11.09%**	10.56%
Net interest income as a percentage of average earning assets	**0.85%**	0.75%
Charge-offs, net of recoveries, to average loans	**<0.01%**	<0.01%
Operating expenses as a percentage of net interest income and noninterest income	**35.08%**	39.19%
Operating expenses as a percentage of average earning assets	**0.38%**	0.35%

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at September 30, 2008, was $11,420,702, reflecting an increase of $554,711, or 5.1 percent, compared to $10,865,991 at December 31, 2007. The changes are net of the effect of the sale of a total of $800 million in participations in its direct notes receivable from associations to another Farm Credit entity during the first nine months of 2008. At September 30, 2008, the cumulative total of participations in association loans sold was $3.5 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 99.0 percent of total loans and accrued interest at September 30, 2008, compared to 99.7 percent at December 31, 2007.

Comparative balances of high-risk assets follow:

	September 30, 2008	Increase (Decrease) $	Increase (Decrease) %	December 31, 2007
Nonaccrual loans	**$ 44,529**	$ 20,606	86.13 %	$ 23,923
Formally restructured loans	**716**	1	0.14	715
Loans 90 days past due and still accruing interest	**-**	(9,999)	(100.00)	9,999
Total impaired loans	**$ 45,245**	$ 10,608	30.63	$ 34,637

The $20,606 increase in nonaccrual loans included participation loans to four borrowers. 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 0.4 percent of gross loans at September 30, 2008, and 0.3 percent of gross loans at December 31, 2007.

At September 30, 2008, the allowance for loan losses was $12,035, equating to 0.11 percent of total loans outstanding, and 0.40 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. The allowance for loan losses at September 30, 2008, was solely attributable to participation loans.

Liquidity and Funding Sources

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

As of September 30, 2008, the bank exceeded the minimum permanent capital, core surplus, total surplus, and net collateral ratio requirements under Farm Credit Administration regulations. At September 30, 2008, the bank's permanent capital ratio was 13.19 percent, core surplus was 6.17 percent, total surplus was 10.40 percent, and the net collateral ratio was 105.70 percent. Cash and investment securities totaled $2,772,582, or 19.4 percent, of total assets at September 30, 2008, compared to $2,553,101, or 18.9 percent, at December 31, 2007, reflecting an increase of $219,481, or 8.6 percent. Interest-bearing liabilities, consisting of bonds and notes and subordinated debt, increased by $752,902, or 6.0 percent, in order to fund the increases in earning assets previously discussed.

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

The bank's investments included an available-for-sale portfolio with a fair market value of $2.7 billion and a held-to-maturity portfolio recorded at an amortized cost of $52.2 million at September 30, 2008. The held-to-maturity portfolio consisted of mission-related rural housing mortgage-backed securities that had a fair value of $51.7 million. The bank's available-for-sale portfolio includes $93.6 million in asset-backed securities, including $21.0 million in securitizations of SLM Corporation (Sallie Mae) loans and $72.6 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, $70.5 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. In May 2008, the FCA approved the bank's plan of divestiture for this downgraded investment, which indicated the bank's desire to continue to hold the investment. Subsequent changes in market or credit conditions could change these evaluations. The bank continues to monitor these investments. Asset-backed securities represent 4.8 percent of the bank's investment portfolio.

In addition, the bank's liquidity investment portfolio includes $101.3 million of money market holdings in The Reserve U.S. Government Fund (Government Fund). This fund is composed of short-term senior debt securities issued by Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Association (Freddie Mac), Federal Home Loan Bank and Farm Credit System. Effective September 18, 2008, the Securities and Exchange Commission (SEC) issued an order, at the request of The Reserve, to suspend all rights of redemption on its Government Fund and other funds. The Reserve was experiencing heavy redemption requests on all of its funds due to the negative publicity associated with its Primary Fund's net asset value (NAV) falling below $1 per share. The Reserve's Primary Fund was holding commercial paper issued by Lehman Brothers Holdings, Inc. when it filed bankruptcy on September 15, 2008. The bank has no holdings in the Primary Fund. The SEC's goal is to ensure an orderly disposition of the securities in the Government Fund to maintain the integrity of the fund's NAV of $1.00 per share. The Government Fund is continuing to be priced daily and is reporting NAV of $1.00 which means the bank's investment is valued at par. The Reserve is working with the SEC to finalize an ultimate liquidation plan for the Government Fund. Distributions from the Government Fund are expected to begin in the fourth quarter of 2008. The fund is currently rated AAA/watch negative and is an eligible liquidity investment by regulation.

Capital Resources

Total shareholders' equity at September 30, 2008, totaled $759,515, an increase of $30,914 from December 31, 2007. This increase is the result of net income of $62,365 for the nine months ended September 30, 2008, an adjustment to accumulated other comprehensive income of $70 related to amortization of pension and other postretirement costs, 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 $17,178, an $882 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 of $5,495.

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 performs other-than-temporary-impairment assessments of our investment securities based on evaluations of both current and future market and credit conditions at each quarter-end. 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 all of its investment in the securities.

Key financial condition comparisons:

	September 30, 2008	December 31, 2007
Total shareholders' equity to total assets	**5.31%**	5.39%
Total liabilities to shareholders' equity	**17.83:1**	17.56:1
Allowance for loan losses to total loans	**0.11%**	0.01%

OTHER

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

The undersigned certify that we have reviewed the September 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

November 4, 2008

Balance Sheets

(dollars in thousands)	September 30, 2008 (Unaudited)	December 31, 2007
Assets		
Cash	**$ 15,220**	$ 16,600
Federal funds sold and securities purchased under resale agreements	**187,398**	125,502
Investment securities	**2,569,964**	2,410,999
Loans	**11,420,702**	10,865,991
Less allowance for loan losses	**12,035**	1,065
Net loans	**11,408,667**	10,864,926
Accrued interest receivable	**63,326**	66,789
Premises and equipment, net	**5,342**	2,719
Other assets	**55,326**	33,243
Total assets	**$ 14,305,243**	$ 13,520,778
Liabilities and shareholders' equity		
Liabilities		
Bonds and notes, net	**$ 13,326,917**	$ 12,624,015
Subordinated debt	**50,000**	-
Accrued interest payable	**116,388**	110,188
Other liabilities	**52,423**	57,974
Total liabilities	**13,545,728**	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	**378,102**	329,198
Accumulated other comprehensive loss	**(22,647)**	(4,657)
Total shareholders' equity	**759,515**	728,601
Total liabilities and shareholders' equity	**$ 14,305,243**	$ 13,520,778

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

Statements of Income

(unaudited)

(dollars in thousands)	Quarter Ended September 30, 2008	Quarter Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Interest Income				
Investment securities	**$ 27,169**	$ 32,635	**$ 82,243**	$ 100,256
Loans	**135,798**	160,252	**414,293**	465,263
Total interest income	**162,967**	192,887	**496,536**	565,519
Interest Expense				
Bonds, notes, and subordinated debt	**132,592**	168,102	**408,695**	490,720
Net interest income	**30,375**	24,785	**87,841**	74,799
Provision (negative provision) for loan losses	**5,998**	(282)	**10,745**	118
Net interest income after provision for loan losses	**24,377**	25,067	**77,096**	74,681
Noninterest Income				
Fees for services to associations	**2,351**	2,276	**7,038**	6,593
Loan-related fees	**1,310**	1,038	**4,322**	3,465
Gain from sale of investment securities	**-**	-	**-**	543
Miscellaneous income, net	**3,858**	1,282	**13,394**	4,556
Total noninterest income	**7,519**	4,596	**24,754**	15,157
Noninterest Expense				
Salaries and employee benefits	**5,603**	5,092	**19,973**	17,496
Occupancy and equipment	**1,307**	1,153	**3,686**	3,747
Insurance Fund premiums	**1,924**	917	**4,188**	2,766
Gains on other property owned, net	**(5)**	-	**(16)**	(12)
Other operating expenses	**3,919**	3,661	**11,654**	11,249
Total noninterest expense	**12,748**	10,823	**39,485**	35,246
Net Income	**$ 19,148**	$ 18,840	**$ 62,365**	$ 54,592

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	-	-	-	54,592	-	54,592
Net change in unrealized net losses on investment securities	-	-	-	-	12,125	12,125
Total comprehensive income	-	-	-	54,592	12,125	66,717
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(6,110)	-	(6,110)
Shareholders' equity	-	-	3	(3)	-	-
Balance at September 30, 2007	$ 200,000	$ 161,421	$ 6,197	$ 358,994	$ (9,345)	$ 717,267
Balance at December 31, 2007	$ 200,000	$ 198,864	$ 5,196	$ 329,198	$ (4,657)	$ 728,601
Comprehensive income						
Net income	-	-	-	62,365	-	62,365
Amortization of costs included in net periodic pension costs	-	-	-	-	70	70
Net change in unrealized net losses on investment securities	-	-	-	-	(17,178)	(17,178)
Net change in unrealized net gains on cash flow derivatives	-	-	-	-	(882)	(882)
Total comprehensive income	-	-	-	62,365	(17,990)	44,375
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	-	-	-	(5,495)	-	(5,495)
Shareholders' equity	-	-	(1)	1	-	-
Balance at September 30, 2008	**$ 200,000**	**$ 198,865**	**$ 5,195**	**$ 378,102**	**$ (22,647)**	**$ 759,515**

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

Statements of Cash Flows

(unaudited)

(dollars in thousands)	Nine Months Ended September 30, 2008	2007
Operating activities		
Net income	**$ 62,365**	$ 54,592
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	**10,745**	118
Depreciation and amortization on premises and equipment	**821**	674
Accretion of net discount on loans	**(335)**	(279)
Amortization and accretion on debt instruments	**(1,720)**	(1,774)
Amortization of net discount (premium) on investment securities	**339**	(2,201)
Gain on sale of investment securities	**-**	(543)
Losses from sales of other property owned, net	**(16)**	-
(Gains) losses from sales of premises and equipment	**(2)**	2
Decrease (increase) in accrued interest receivable	**3,463**	(11,571)
Increase in other assets	**(4,878)**	(4,101)
Increase in accrued interest payable	**6,200**	30,855
Increase in other liabilities	**4,768**	2,505
Net cash provided by operating activities	**81,750**	68,277
Investing activities		
Net increase in federal funds sold and securities purchased under resale agreements	**(61,896)**	(75,351)
Investment securities		
Purchases	**(2,310,629)**	(3,222,546)
Proceeds from maturities, calls and prepayments	**2,134,147**	3,376,056
Proceeds from sales	**-**	83,163
Investment in Farmer Mac preferred stock	**(7,000)**	-
Patronage stock from System banks	**(6,408)**	(1,972)
Increase in loans, net	**(1,358,211)**	(1,521,460)
Proceeds from sale of loans	**800,000**	600,000
Proceeds from sales of premises and equipment	**2**	108
Expenditures for premises and equipment	**(3,444)**	(1,085)
Net cash used in investing activities	**(813,439)**	(763,087)
Financing activities		
Bonds and notes issued	**36,819,746**	20,564,392
Subordinated debt issued, net of costs	**49,433**	-
Bonds and notes retired	**(36,118,013)**	(19,858,213)
Capital stock issued	**1**	-
Cash dividends on preferred stock	**(7,561)**	(7,561)
Cash patronage distributions paid	**(13,297)**	(11,661)
Net cash provided by financing activities	**730,309**	686,957
Net decrease in cash	**(1,380)**	(7,853)
Cash at beginning of year	**16,600**	14,165
Cash at end of quarter	**$ 15,220**	$ 6,312
Supplemental schedule of noncash investing and financing activities		
Net (increase) decrease in unrealized losses on investment securities	**$ (17,178)**	$ 12,125
Supplemental schedule of noncash changes in fair value related to hedging activities		
Increase in bonds and notes	**$ 2,889**	$ 10,168
Supplemental information		
Interest paid	**$ 402,495**	$ 459,865

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 third 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 September 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:

	Nine Months Ended September 30,	
	2008	2007
Balance at beginning of period	**$ 1,065**	$ 142
Provision for loan losses	**10,745**	118
Loans charged off	**-**	(217)
Recoveries	**225**	97
Balance at end of period	**$ 12,035**	$ 140

At September 30, 2008, impaired loans of $40.5 million had a related specific allowance of $10.7 million, while the remaining $4.7 million of impaired loans had no related specific allowance.

The average recorded investment in impaired loans for the nine months ended September 30, 2008, was $24.6 million. The bank recognized interest income of $127 on impaired loans during the nine months ended September 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 September 30, 2008, were approximately $173.6 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 September 30, 2008			
	Total	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available-for-sale investment securities	**$ 2,705,207**	$ -	$ 2,489,548	$ 215,659
Derivatives, net	**8,863**	-	8,863	-
Total	**$ 2,714,070**	$ -	$ 2,498,411	$ 215,659

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 September 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	(868)
Purchases, issuances and settlements	(40,013)
Net transfers from Level 3	(16,691)
Balance at September 30, 2008	$ 215,659

The net losses included in other comprehensive income in the above table are all on securities held at September 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 September 30, 2008, include certain asset-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 nine months ended September 30:

	Pension Benefits		Other Benefits	
	2008	2007	**2008**	2007
Service cost	**$ 305**	$ 276	**$ 126**	$ 143
Interest cost	**409**	320	**310**	288
Amortization of prior service costs	**265**	496	**(229)**	(255)
Amortization of net loss	**38**	-	**(4)**	(4)
Net periodic benefit cost	**$ 1,017**	$ 1,092	**$ 203**	$ 172

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 — SUBORDINATED DEBT

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

NOTE 7 — 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	**September 30, 2008**	December 31, 2007
Cash	**$ 14,015**	39,103
Investment securities	**18,541**	-
Loans	**13,394,341**	12,300,861
Less allowance for loan losses	**38,631**	23,430
Net loans	**13,355,710**	12,277,431
Accrued interest receivable	**221,440**	197,117
Other property owned, net	**753**	1,817
Other assets	**275,889**	262,802
Total assets	**$ 13,886,348**	$ 12,778,270
Notes payable to Farm Credit Banks	**$ 11,773,095**	$ 10,747,261
Other liabilities	**188,130**	252,204
Total liabilities	**11,961,225**	10,999,465
Capital stock and participation certificates	**64,868**	63,267
Retained earnings	**1,850,552**	1,705,238
Accumulated other comprehensive income	**9,703**	10,300
Total members' equity	**1,925,123**	1,778,805
Total liabilities and members' equity	**$ 13,886,348**	$ 12,778,270

	Nine Months Ended September 30,	
Statement of income data	**2008**	2007
Interest income	**$ 636,692**	$ 654,416
Interest expense	**373,158**	408,122
Net interest income	**263,534**	246,294
Provision for loan losses	**16,759**	35,235
Net interest income after provision for loan losses	**246,775**	211,059
Noninterest income	**53,594**	44,634
Other expense	**127,267**	109,911
Provision for income taxes	**355**	587
Net income	**$ 172,747**	$ 145,195