

FARM CREDIT FOCUS



2009 THIRD QUARTER REPORT
FARM CREDIT BANK OF TEXAS
SEPTEMBER 30, 2009

THIRD QUARTER 2009

Table of Contents

Management's Discussion and Analysis of Financial Condition and Results of Operations	2
Controls and Procedures	10
Financial Statements:	
Balance Sheets	11
Statements of Income.....	12
Statements of Changes in Shareholders' Equity	13
Statements of Cash Flows	14
Notes to Financial Statements.....	15

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, 2009. These comments should be read in conjunction with the accompanying financial statements and footnotes, along with the 2008 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 (FCA) 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 their districts. 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 district. At September 30, 2009, the bank provided financing to 19 district associations and certain other financing institutions.

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended September 30, 2009, was \$20,200, an increase of \$1,052, or 5.5 percent, from the quarter ended September 30, 2008. The \$1,052 increase in net income for the third quarter of 2009 consisted of a \$14,292 increase in net interest income and a \$6,294 increase in noninterest income, offset by a \$16,699 increase in provision for loan losses and a \$2,835 increase in noninterest expense.

Net income for the nine months ended September 30, 2009, was \$64,126, an increase of \$1,761, or 2.8 percent, over the same period of 2008. The increase in net income for the nine months ended September 30, 2009, consisted of a \$31,703 increase in net interest income and a \$4,569 increase in noninterest income, offset by a \$21,911 increase in provision for loan losses and a \$12,600 increase in noninterest expense.

Net Interest Income

Net interest income for the three months ended September 30, 2009, was \$44,667, an increase of \$14,292, or 47.1 percent, from the three months ended September 30, 2008. The increase in net interest income for the quarter ended September 30, 2009, was attributable to a 56-basis-point increase in the bank's interest rate spread, net of the effects of a \$433.1 million decrease in average earning assets. Net interest income for the nine months ended September 30, 2009, was \$119,544, an increase of \$31,703, or 36.1 percent, over the same period of 2008. The increase in net interest income for the nine months was attributable to a volume increase of \$194.6 million in the bank's average earning assets and a 41-basis-point increase in the bank's interest rate spread. Interest rate spreads increased primarily as a result of calling high-cost debt and replacing it with lower-cost debt. From September 30, 2008, to September 30, 2009, the bank was able to replace debt totaling \$8.6 billion with debt that had lower interest rates and shorter maturities

that match earning assets. In addition, the bank increased its interest rate spread on its participation loan portfolio.

Provision for Loan Losses

The bank's provision for loan losses for the quarter ended September 30, 2009, was \$22,697, an increase of \$16,699 over the \$5,998 provision for the third quarter of 2008. Provision for loan losses for the nine months ended September 30, 2009, was \$32,656, an increase of \$21,911 over the same period of 2008. During the first nine months of 2009, the bank has recorded \$28,825 in specific provisions on participation loans. The specific provision reflects credit deterioration primarily in those agricultural sectors that continue to be impacted by the volatility in commodity prices, such as the ethanol, livestock and poultry sectors as well as those borrowers impacted by the overall downturn in the general economy, primarily telecommunications. In addition, during September 2009, the bank recorded a \$3,831 general provision for loan losses. The general provision reflects expected credit deterioration in the participation loan portfolio due to general economic conditions. There is no provision for loan losses recorded for the bank's direct notes receivable from associations and other financing institutions. The allowance for loan losses of \$37,666 at September 30, 2009, was considered adequate by management to absorb probable losses inherent to its loan portfolio.

Noninterest Income

Noninterest income for the quarter ended September 30, 2009, was \$13,813, an increase of \$6,294, or 83.7 percent, over the same period of 2008. Noninterest income for the nine months ended September 30, 2009, was \$29,323, an increase of \$4,569, or 18.5 percent, over the same period of 2008. The increase for the third quarter of 2009 over the same period of 2008 was due mainly to a \$5,644 gain on sale of investments, a \$1,148 increase in fees for loan-related services, and a \$181 increase in all other noninterest items, collectively, offset by a \$679 impairment loss recognized due to the estimated amount of credit loss related to an other-than-temporary impairment on investment securities — which is more fully discussed in Note 2, "Investments." The \$5,644 gain on sale of investments relates to the bank's sale of six agency mortgage-backed securities with an amortized cost of \$106.0 million in order to begin implementation of the bank's liquidity standards which entails the conversion of certain assets into cash.

The \$4,569 increase in noninterest income for the nine months ended September 30, 2009, compared to the same period of 2008 was primarily the result of the \$5,644 gain on sale of investments referred to above, a \$2,138 increase in fees for loan-related services, and a \$299 increase in all other noninterest items, collectively, offset by a \$3,017 impairment loss recognized due to the estimated amount of credit loss related to an other-than-temporary impairment on investment securities — which is more fully discussed in Note 2, "Investments" — and a \$495 decrease in patronage income from another System bank.

Noninterest Expense

Noninterest expense for the three and nine months ended September 30, 2009, was \$15,583 and \$52,085, respectively, an increase of \$2,835 and \$12,600, respectively, over the same periods of 2008. The increase for the third quarter is primarily attributable to a \$1,849 increase in salaries and employee benefits, a \$700 increase in other operating expenses, a \$150 increase in occupancy and equipment expenses, and a \$131 increase in premiums to the Farm Credit System Insurance Corporation (FCSIC or Insurance Fund). The \$1,849 increase in salaries and employee benefits was primarily due to a \$1,428 increase in compensation and related payroll taxes and a \$759 increase in pension and retirement expenses, offset by a \$338 decrease in other benefits. Compensation increased due to a \$964 accrual of deferred compensation for the bank's chief executive officer as outlined in the bank's 2008 Annual Report to shareholders, and to increases in the number of employees and increases in compensation rates.

The increase in pension and retirement benefits was primarily the result of increased contributions to the district's multi-employer defined benefit pension plan. Contributions from the plan's various employers were increased in response to declines in market values of the plan's investments during the last half of 2008. Other operating expenses increased due to an \$809 increase in professional and contract services, offset by a \$92 decrease in communication expenses and a \$17 decrease in all other operating expenses, collectively. The increase in professional and contract services includes the effects of increased monitoring of association credit functions and consultation fees related to the pending lending system initiative.

The \$12,600 increase in noninterest expense for the nine months ended September 30, 2009, compared to the same period of 2008 was due mainly to a \$6,102 increase in salaries and employee benefits, a \$2,933 increase in premiums to the Insurance Fund, a \$2,909 increase in other operating expenses, a \$651 increase in occupancy and equipment expenses, and a \$5 decrease in gains on other property owned. The \$6,102 increase in salaries and employee benefits was primarily due to a \$4,801 increase in compensation and related payroll taxes and a \$2,395 increase in pension and retirement expenses, offset by a \$1,094 decrease in other benefits. Compensation increased due to a \$2.9 million accrual of deferred compensation for the bank's chief executive officer as outlined in the bank's 2008 Annual Report to shareholders, to increases in the number of employees and to increases in compensation rates. The increase in pension and retirement benefits was primarily the result of increased contributions to the district's multi-employer defined benefit pension plan. As previously discussed, contributions from the plan's various employers were increased in response to declines in market values of the plan's investments during the last half of 2008. The \$2,933 increase in premiums paid to the Insurance Fund was primarily due to a change effective July 1, 2008, in the premium base reference from loans to Systemwide debt outstanding as well as an increase in the premium rate which began in January 2009. Other operating expenses increased due to a \$1,686 increase in professional and contract services and a \$1,351 increase in Funding Corporation assessment fees, offset by a \$128 decrease in all other operating expenses, collectively. The increase in professional and contract services includes the effects of increased monitoring of association credit functions, legal fees and consultation fees related to the new loan accounting systems initiative.

Key results of operations comparisons:

	Annualized for the Nine Months Ended 9/30/2009	Annualized for the Nine Months Ended 9/30/2008
Return on average assets	0.60%	0.60%
Return on average shareholders' equity	10.72%	11.09%
Net interest income as a percentage of average earning assets	1.14%	0.85%
Charge-offs, net of recoveries, to average loans	0.09%	<0.01%
Operating expenses as a percentage of net interest income and noninterest income	34.99%	35.08%
Operating expenses as a percentage of average earning assets	0.49%	0.38%

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at September 30, 2009, was \$11,330,155, a decrease of \$72,958, or 0.6 percent, compared to \$11,403,113 at December 31, 2008. The changes include the effect of the purchase of \$100 million in participations in the bank's direct notes receivable from associations from another System bank during January 2009. At September 30, 2009, the cumulative total of participations in association loans sold to another System bank was \$3.4 billion. The decrease in the loan portfolio is mainly attributable to decreases in the bank's capital markets loan portfolio, offset by growth in the bank's direct loans to associations and other financing institutions. The relatively flat growth of the bank's loan volume during the first nine months of 2009 was due to the lessening of loan demand and the tightening of underwriting standards by the bank during the recent adverse economic and financial environment. Loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" were 94.4 percent of total loans and accrued interest at September 30, 2009, compared to 98.9 percent at December 31, 2008. The decrease in credit quality reflects deterioration primarily in those agricultural sectors that continue to be impacted by the volatility in commodity prices, such as the ethanol, livestock, poultry and dairy sectors as well as those borrowers impacted by the overall downturn in the general economy. Credit conditions as described above also are impacting our associations' credit quality and, consequently, the bank's direct loans to associations. Given the current adversity in the general economy, the bank does not anticipate significant improvements in overall credit quality in the near term.

Comparative balances of high risk assets follow:

	September 30, 2009	Increase (Decrease)		December 31, 2008
		\$	%	
Nonaccrual loans	\$ 203,020	\$ 93,358	85.13 %	\$ 109,662
Formally restructured loans	675	(15)	(2.17)	690
Loans 90 days past due and still accruing interest	-	-	-	-
Total impaired loans	<u>\$ 203,695</u>	<u>\$ 93,343</u>	84.59	<u>\$ 110,352</u>

The \$93,358 increase in nonaccrual loans is primarily the result of increases in the ethanol, livestock, telecommunications and timber sectors. The increase is net of the effect of repayments on other nonaccrual loans and the reinstatement to accrual status of two loans totaling \$10.5 million related to a beef processor. At September 30, 2009, \$167.9 million, or 82.7 percent, of the bank's nonaccrual loans were considered current as to principal and interest. Continued satisfactory payment performance on these loans may indicate potential for a return to accrual status. Nonaccrual loans on which interest income from cash payments is recognized totaled \$3.9 million at September 30, 2009, compared to \$8.4 million at December 31, 2008.

Impaired loans, consisting of nonaccrual loans, formally restructured loans and loans 90 days or more past due and still accruing interest, constituted 1.8 percent of gross loans at September 30, 2009, and 1.0 percent of gross loans at December 31, 2008. The bank had no "other property owned" recorded at September 30, 2009, or at December 31, 2008. During 2009, there was an \$8.1 million acquisition of an ethanol facility following a credit bid process. Subsequently, this facility was sold for \$8.4 million to a cooperative in a seller-financed transaction. Gain of \$331 on this subsequent transaction will be deferred and will be recognized in earnings on an installment basis.

The allowance for loan losses as a percentage of impaired loans was 18.5 percent as of September 30, 2009, as compared to 11.4 percent as of December 31, 2008. The relatively low percentage is

attributable to the fact that 82.7 percent of the loans considered impaired are current as to principal and interest payments and the strength of the security (primarily first lien real estate) supporting many of the impaired loans.

At September 30, 2009, the allowance for loan losses was \$37,666, equating to 0.33 percent of total loans outstanding, and 1.38 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, 2009, was solely attributable to participation loans.

Liquidity and Funding Sources

Cash and investment securities totaled \$2,530,706, or 18.0 percent, of total assets at September 30, 2009, compared to \$3,218,259, or 21.8 percent, at December 31, 2008, a decrease of \$687,553, or 21.4 percent. The decrease in cash and investment securities is primarily the result of pay-downs on investment securities, the proceeds of which were used to reduce debt. At September 30, 2009, the bank's cash balance was \$309,984, a \$296,891 increase over December 31, 2008. This increase is due to the bank's liquidity management strategy to convert certain investments into cash. Interest-bearing liabilities, consisting of bonds, notes and subordinated debt, decreased by \$767,317, or 5.6 percent, in concert with the decrease in earning assets requiring funding.

Investments

The bank's investments included an available-for-sale portfolio with a fair value of \$2.2 billion and a held-to-maturity portfolio recorded at an amortized cost of \$41.4 million at September 30, 2009. The held-to-maturity portfolio consisted of mission-related rural housing mortgage-backed securities that had a fair value of \$43.1 million. The bank's available-for-sale portfolio consisted primarily of federal agency collateralized mortgage-backed securities, corporate debt, other collateralized mortgage-backed securities and asset-backed securities. At September 30, 2009, the bank held 10 investments that were ineligible for liquidity purposes by FCA regulations, due to credit ratings that were below AAA by both Moody's Investors Service and Standard & Poor's. Those ineligible securities had an amortized cost basis of \$73,953 and a fair value of \$63,330 at September 30, 2009.

The types of agency debt, corporate debt, mortgage-backed and asset-backed securities that are included in the bank's available-for-sale investment portfolio were (in thousands):

	September 30, 2009		December 31, 2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Agency debt	\$ -	\$ -	\$ 500,000	\$ 500,957
Corporate debt	232,045	234,113	536,970	536,316
Federal agency collateralized mortgage obligations	1,730,243	1,765,880	1,661,323	1,681,033
Other collateralized mortgage obligations	139,256	125,626	227,165	192,581
Asset-backed securities	37,350	33,412	73,499	67,041
Total available-for-sale investments	<u>\$ 2,138,894</u>	<u>\$ 2,159,031</u>	<u>\$ 2,998,957</u>	<u>\$ 2,977,928</u>

As is more fully disclosed in Note 1, "Organization and Significant Accounting Policies," and in Note 2, "Investments," the bank early adopted Financial Accounting Standards Board (FASB) guidance, "Recognition and Presentation of Other-Than-Temporary Impairments," which amends existing impairment guidance, "Accounting for Certain Investments in Debt and Equity Investments."

Accordingly, the bank recognized other-than-temporary impairment losses on four mortgage-backed investments during 2009. The credit portion of the impairment losses, recognized as a loss in earnings, totaled \$3,017 for the nine months ended September 30, 2009. The non-credit-related impairment losses totaling \$5,204 on the four investments are included as a charge against other comprehensive income. Also in accordance with this guidance, \$1,527 in non-credit-related impairment losses taken as a charge against earnings during 2008 were added back to retained earnings and charged against accumulated other comprehensive income in the first quarter of 2009.

Farm Credit Administration regulations define eligible investments by specifying credit rating criteria, final maturity limit, percentage of investment portfolio limit and certain other requirements for each investment type. At the time the investments are purchased, they must be highly rated by at least one Nationally Recognized Statistical Rating Organization, such as Moody's Investors Service, Standard & Poor's or Fitch Ratings.

If an investment no longer meets the credit rating criteria referred to above, the investment becomes ineligible. A bank must dispose of an investment that becomes ineligible within six months, unless the Farm Credit Administration approves, in writing, a plan that authorizes the bank to divest the instrument over a longer period of time. The Farm Credit Administration has approved, with conditions, plans submitted by the bank and is in the process of reviewing other plans that have been submitted. To date, the Farm Credit Administration has not required disposition of any of these securities.

The following table sets forth investments available-for-sale at fair value by credit rating:

	Eligible				Ineligible								Total
	AAA/Aaa	AA/Aa	A1/P1/F1	Split Rated	AA/BBB Split Rated	A-/BB- Split Rated	B3/BBB/B Split Rated	BBB/Baa	BB/Ba	B3/CCC/ CC	CCC/Caa		
September 30, 2009													
Corporate debt	\$ 204,118	\$ 29,995	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 234,113	
Federal agency collateralized mortgage obligations	1,765,880	-	-	-	-	-	-	-	-	-	-	1,765,880	
Other collateralized mortgage obligations	39,518	-	-	26,796	6,160	2,663	8,701	-	12,306	12,787	16,695	125,626	
Asset-backed securities	22,964	-	-	6,430	-	-	-	2,284	1,734	-	-	33,412	
Total	\$ 2,032,480	\$ 29,995	\$ -	\$ 33,226	\$ 6,160	\$ 2,663	\$ 8,701	\$ 2,284	\$ 14,040	\$ 12,787	\$ 16,695	\$ 2,159,031	
	Eligible				Ineligible								Total
	AAA/Aaa	AA/Aa	A1/P1/F1	Split Rated	AA/BBB Split Rated	A-/BB- Split Rated	B3/BBB/B Split Rated	BBB/Baa	BB/Ba	B3/CCC/ CC	CCC/Caa		
December 31, 2008													
Agency debt	\$ 500,957	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 500,957	
Corporate debt	282,069	-	194,993	59,254	-	-	-	-	-	-	-	536,316	
Federal agency collateralized mortgage obligations	1,681,033	-	-	-	-	-	-	-	-	-	-	1,681,033	
Other collateralized mortgage obligations	135,153	-	-	44,744	-	-	-	12,684	-	-	-	192,581	
Asset-backed securities	56,060	-	-	8,733	-	-	-	2,248	-	-	-	67,041	
Total	\$ 2,655,272	\$ -	\$ 194,993	\$ 112,731	\$ -	\$ -	\$ -	\$ 14,932	\$ -	\$ -	\$ -	\$ 2,977,928	

The increase in ineligible investments is primarily due to the continued credit deterioration on certain residential mortgage-related securities.

Capital Resources

As of September 30, 2009, the bank exceeded the minimum permanent capital, core surplus, total surplus and net collateral ratio requirements under Farm Credit Administration regulations. At September 30, 2009, the bank's permanent capital ratio was 14.56 percent, core surplus was 5.85 percent, total surplus

was 11.09 percent and the net collateral ratio was 105.11 percent. The net collateral ratio reflects an 85-basis-point temporary reduction due to a \$111.6 million increase in receivables not considered available collateral by regulation at September 30, 2009, related to the sale of securities for which cash was collected and reflected in collateral assets on October 2, 2009. Total shareholders' equity at September 30, 2009, totaled \$842,676, an increase of \$98,134 from December 31, 2008. This increase is the result of net income of \$64,126 for the nine months ended September 30, 2009, a decrease in unrealized net losses on investment securities totaling \$41,165, a \$3,073 unrealized gain on cash flow derivatives, an adjustment to retained earnings of \$1,527 resulting from the effects the noncredit portion of the previous other-than-temporary impairment losses recorded in the first quarter of 2009, and a \$187 amortization related to retirement benefits, offset by dividends paid on preferred stock totaling \$7,561, patronage paid of \$4,382 and a \$1 retirement of capital stock.

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 changes in the market value of mortgage-backed and asset-backed securities. The bank performs other-than-temporary impairment assessments on investment securities based on evaluations of both current and future market and credit conditions at each quarter end. The process for evaluation of impairment of investments is more fully discussed in Note 2, "Investments."

Key financial condition comparisons:

	<u>September 30, 2009</u>	<u>December 31, 2008</u>
Total shareholders' equity to total assets	5.99%	5.04%
Total liabilities to shareholders' equity	15.68:1	18.82:1
Allowance for loan losses to total loans	0.33%	0.11%

OTHER

For the quarter ended September 30, 2009, the Farm Credit Bank of Texas, effective November 9, 2009, was placed into the "Category I" designation of the Amended and Restated Market Access Agreement (MAA), as a result of the district falling below a defined Amended and Restated Contractual Interbank Performance Agreement (CIPA) score standard. The district's CIPA score dropped principally as a result of increases in adversely classified assets, including nonperforming assets. Although the nonperforming assets of the district have increased over the last several quarters, as has been the case generally with most other financial institutions, the district continued to achieve healthy earnings and maintain relatively strong capital levels. (See the Management's Discussion and Analysis, "Structural Risk Management," of the 2008 Annual Report to shareholders for additional information about the MAA and the CIPA.)

Under the MAA, once a System bank is placed in "Category I," a committee of representatives from the System banks and Funding Corporation (Committee) is formed within seven days after receiving notice of noncompliance by the System bank. Within 30 days of receiving a notice, the System bank in "Category I" is required to provide to the Committee certain information, including (a) a detailed explanation of the causes of the System bank being in "Category I," (b) an action plan to improve the System bank's financial situation so that it is no longer in "Category I," (c) a timetable for achieving that result, and (d) certain financial information, such as a business plan and external auditor reports. In addition, periodic updates are provided to the Committee regarding certain bank financial information and credit quality indicators as well as certain regulatory information. No economic penalties are associated with being placed into "Category I."

A System bank exits “Category I” by returning to compliance with each of the agreed-upon standards under the MAA. The Farm Credit Bank of Texas is developing a plan to address and reduce the district’s nonperforming assets. This plan contemplates the district will sufficiently reduce its nonperforming loans to allow the Farm Credit Bank of Texas to exit “Category I” and return to being in compliance with the MAA.


On October 5, 2009, Fitch Ratings affirmed the long-term and short-term Issuer Default Ratings of Farm Credit Bank of Texas at “AA-” and “F1+,” respectively. The rating action “reflects continued stable operating performance, a manageable increase in loan delinquency, and conservative liquidity and capital management.”

On September 30, 2009, amendments to the bank’s bylaws were approved by the bank’s stockholders. The amendments allow for the creation of a Capitalized Participation Pool and authorization for the attribution of the bank’s unallocated retained earnings in memorandum accounts to district associations and other financing institutions based on their average direct loan balances with the bank on a cooperative basis. Also, there was an omnibus approval of a \$500 million preferred stock revolver, allowing the bank to issue, in aggregate, up to \$500 million of preferred stock outstanding at any one time during a 10-year period, subject to the approval of the terms by the bank’s board of directors and prior notification and approval of the FCA.

The undersigned certify that we have reviewed the September 30, 2009, 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
Senior Vice President, Chief Financial Officer, Chief Operations Officer

November 9, 2009

Controls and Procedures

The Farm Credit Bank of Texas (bank) maintains a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. With management's input, the chief executive officer and the senior vice president, chief financial officer, chief operations officer have evaluated our disclosure controls and procedures as of the end of and for the period covered by this quarterly report, and have concluded that our disclosure controls and procedures are effective as of that date.

The bank also maintains a system of internal controls. The "internal controls" as defined by the American Institute of Certified Public Accountants' Codification of Statement on Auditing Standards, AU Section 319, means a process — effected by the board of directors, management and other personnel — designed to provide reasonable assurance regarding the achievement of objectives in the reliability of our financial reporting, the effectiveness and efficiency of operations, and of compliance with applicable laws and regulations. We continually assess the adequacy of our internal control over financial reporting and enhance our controls in response to internal control assessments, and internal and external audit and regulatory recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations.



Larry R. Doyle
Chief Executive Officer



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

November 9, 2009

Balance Sheets

(dollars in thousands)	September 30, 2009 (Unaudited)	December 31, 2008
Assets		
Cash	\$ 309,984	\$ 13,093
Federal funds sold and securities purchased under resale agreements	20,338	176,698
Investment securities	2,200,384	3,028,468
Loans	11,330,155	11,403,113
Less allowance for loan losses	37,666	12,549
Net loans	11,292,489	11,390,564
Accrued interest receivable	51,846	63,632
Premises and equipment, net	11,256	6,772
Other assets	171,224	81,274
Total assets	\$ 14,057,521	\$ 14,760,501
Liabilities and shareholders' equity		
Liabilities		
Bonds and notes, net	\$ 13,034,888	\$ 13,802,205
Subordinated debt	50,000	50,000
Accrued interest payable	83,333	96,847
Other liabilities	46,624	66,907
Total liabilities	13,214,845	14,015,959
Commitments and contingent liabilities (Note 4)		
Shareholders' equity		
Preferred stock, net	200,000	200,000
Capital stock	227,211	227,212
Allocated retained earnings	6,161	6,114
Unallocated retained earnings	390,662	336,999
Accumulated other comprehensive income (loss)	18,642	(25,783)
Total shareholders' equity	842,676	744,542
Total liabilities and shareholders' equity	\$ 14,057,521	\$ 14,760,501

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

Statements of Income

(unaudited)

(dollars in thousands)	Quarter Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Interest Income				
Investment securities	\$ 20,439	\$ 27,169	\$ 70,036	\$ 82,243
Loans	116,270	135,798	360,860	414,293
Total interest income	136,709	162,967	430,896	496,536
Interest Expense				
Bonds, notes and subordinated debt	92,042	132,592	311,352	408,695
Net interest income	44,667	30,375	119,544	87,841
Provision for loan losses	22,697	5,998	32,656	10,745
Net interest income after provision for loan losses	21,970	24,377	86,888	77,096
Noninterest Income				
Fees for services to associations	2,320	2,351	6,824	7,038
Loan-related fees	2,458	1,310	6,460	4,322
Gain from sale of investment securities	5,644	-	5,644	-
Miscellaneous income, net	4,070	3,858	13,412	13,394
Impairment losses on investments				
Total other-than-temporary impairment losses	(3,476)	-	(8,221)	-
Less: portion of loss recognized in other comprehensive income	2,797	-	5,204	-
Net impairment loss recognized in earnings	(679)	-	(3,017)	-
Total noninterest income	13,813	7,519	29,323	24,754
Noninterest Expense				
Salaries and employee benefits	7,452	5,603	26,075	19,973
Occupancy and equipment	1,457	1,307	4,337	3,686
Insurance Fund premiums	2,055	1,924	7,121	4,188
Gains on other property owned, net	-	(5)	(11)	(16)
Other operating expenses	4,619	3,919	14,563	11,654
Total noninterest expense	15,583	12,748	52,085	39,485
Net Income	\$ 20,200	\$ 19,148	\$ 64,126	\$ 62,365

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, 2007	\$ 200,000	\$ 198,864	\$ 5,196	\$ 329,198	\$ (4,657)	\$ 728,601
Adjustment for accounting changes:						
Change in benefits measurement date	-	-	-	(406)	-	(406)
Balance at January 1, 2008	200,000	198,864	5,196	328,792	(4,657)	728,195
Comprehensive income						
Net income	-	-	-	62,365	-	62,365
Change in pension and postretirement benefit plans	-	-	-	-	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
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
Balance at December 31, 2008	\$ 200,000	\$ 227,212	\$ 6,114	\$ 336,999	\$ (25,783)	\$ 744,542
Noncredit portion of previous other-than-temporary impairment losses	-	-	-	1,527	(1,527)	-
Balance at January 1, 2009	200,000	227,212	6,114	338,526	(27,310)	744,542
Comprehensive income						
Net income	-	-	-	64,126	-	64,126
Change in pension and postretirement benefit plans	-	-	-	-	187	187
Net change in unrealized net gains on investment securities	-	-	-	-	47,896	47,896
Noncredit portion of current other-than-temporary impairment losses	-	-	-	-	(5,204)	(5,204)
Net change in unrealized net gains on cash flow derivatives	-	-	-	-	3,073	3,073
Total comprehensive income	-	-	-	64,126	45,952	110,078
Capital stock retired	-	(1)	-	-	-	(1)
Preferred stock dividends paid	-	-	-	(7,561)	-	(7,561)
Patronage distributions						
Cash	-	-	-	(4,382)	-	(4,382)
Shareholders' equity	-	-	47	(47)	-	-
Balance at September 30, 2009	\$ 200,000	\$ 227,211	\$ 6,161	\$ 390,662	\$ 18,642	\$ 842,676

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

Statements of Cash Flows

(unaudited)

(dollars in thousands)	Nine Months Ended September 30,	
	2009	2008
Operating activities		
Net income	\$ 64,126	\$ 62,365
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	32,656	10,745
Provision for losses on other property owned	-	-
Depreciation and amortization on premises and equipment	1,098	821
Accretion of net discount on loans	(337)	(335)
Amortization and accretion on debt instruments	(2,698)	(1,720)
Amortization of net premium on investment securities	5,328	339
Gain on sale of investment securities	(5,644)	-
Gain from sales of other property owned, net	(11)	(16)
Losses on impairment of investments available-for-sale	3,017	-
Gain from sales of premises and equipment	-	(2)
Decrease in accrued interest receivable	11,786	3,463
Increase in investment trade receivables	(111,644)	-
Decrease (increase) in other assets	3,407	(4,878)
(Decrease) increase in accrued interest payable	(13,514)	6,200
Increase in other liabilities	250	4,768
Net cash (used in) provided by operating activities	(12,180)	81,750
Investing activities		
Net decrease (increase) in federal funds sold and securities purchased under resale agreements	156,360	(61,896)
Investment securities		
Purchases	(1,087,787)	(2,310,629)
Proceeds from maturities, calls and prepayments	1,843,721	2,134,147
Proceeds from sales	106,331	-
Investment in Farmer Mac preferred stock	-	(7,000)
Allocated equity patronage from System bank	(11,762)	(6,408)
Decrease (increase) in loans, net	164,251	(1,358,211)
(Expenditures) proceeds from (purchase) sale of loans	(100,000)	800,000
Proceeds from sales of premises and equipment	-	2
Expenditures for premises and equipment	(5,582)	(3,444)
Net cash provided by (used in) investing activities	1,065,532	(813,439)
Financing activities		
Bonds and notes issued	37,694,920	36,819,746
Subordinated debt issued, net of costs	-	49,433
Bonds and notes retired	(38,429,442)	(36,118,013)
Capital stock issued	-	1
Capital stock retired	(1)	-
and allocated retained earnings distributed	(7,561)	(7,561)
Cash dividends on preferred stock	(14,377)	(13,297)
Cash patronage distributions paid	(756,461)	730,309
Net cash (used in) provided by financing activities	296,891	(1,380)
Net increase (decrease) in cash	13,093	16,600
Cash at beginning of year	\$ 309,984	\$ 15,220
Cash at end of quarter		
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	\$ 8,109	\$ -
Net decrease (increase) in unrealized losses on investment securities	41,165	(17,178)
Supplemental schedule of noncash changes in fair value related to hedging activities		
(Decrease) increase in bonds and notes	\$ (30,097)	\$ 2,889
Supplemental information		
Interest paid	\$ 324,866	\$ 402,495

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, 2008, are contained in the 2008 Annual Report to shareholders (Annual Report). These unaudited third quarter 2009 financial statements should be read in conjunction with the Annual Report.

Effective January 1, 2009, the bank adopted the Financial Accounting Standards Board (FASB) guidance on “Disclosures about Derivative Instruments and Hedging Activities,” which amends and expands the disclosure requirements for derivative instruments and for hedging activities. The guidance requires 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 guidance is not required for earlier periods at initial adoption and the adoption did not have an impact on the financial position, results of operations or cash flows; however, derivative instruments and hedging activities disclosures have been expanded, as disclosed in Note 7.

Effective January 1, 2009, the bank adopted accounting guidance for fair value measurements of nonfinancial assets and nonfinancial liabilities. The impact of adoption resulted in additional fair value disclosures but does not have an impact on our financial condition or results of operations.

In April 2009, the FASB issued additional guidance, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.” This guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique and inputs used, the objective for fair value measurement is unchanged from what it would be if markets were operating at normal activity levels or transactions were orderly; that is, to determine the current exit price. It sets forth additional factors that should be considered to determine whether there has been a significant decrease in volume and level of activity when compared with normal market activity. The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of evidence, there has been a significant decrease in activity and volume. The guidance indicates that if an entity determines that either the volume or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. It is further noted that a fair value measurement should include a risk adjustment to reflect the amount market participants would demand because of the risk (uncertainty) in the cash flows.

This guidance also requires a reporting entity to make additional disclosures in interim and annual periods. It was effective for interim periods ending after June 15, 2009. The bank adopted this guidance in the first quarter of 2009. Revisions resulting from a change in valuation techniques or their application are accounted for as a change in accounting estimate. The adoption did not have a material impact on the bank and associations' financial position, results of operations or cash flows.

In April 2009, the FASB issued guidance, "Recognition and Presentation of Other-Than-Temporary Impairments," which amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt securities in the financial statements. It does not change existing recognition and measurement guidance related to other-than-temporary impairments of equity securities.

This guidance changes existing impairment guidance related to accounting for certain investments in debt and equity securities by eliminating the "ability and intent to hold" provision. In addition, impairment is now considered to be other than temporary if an entity (i) intends to sell the security, (ii) more likely than not will be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell). The "probability" standard relating to the collectibility of cash flows is also eliminated, and impairment is now considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income. For held-to-maturity securities, the portion of the other-than-temporary impairment not related to a credit loss will be recognized in a new category of other comprehensive income and amortized over the remaining life of the debt security as an increase in the security's carrying amount. Disclosure requirements for impaired debt and equity securities are expanded and will now be required quarterly, as well as annually.

For securities held at the beginning of the interim period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell and it is not more likely than not that it will be required to sell before recovery of its amortized cost basis, the entity shall recognize the cumulative effect of initially applying this guidance as an adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. The bank early adopted the guidance and recognized an adjustment to beginning retained earnings in the amount of \$1,527, and a corresponding adjustment to accumulated other comprehensive income of \$1,527.

In addition, in April 2009, the FASB issued guidance, "Interim Disclosures about Fair Value of Financial Instruments." This guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The guidance was effective for interim periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. The bank adopted the guidance with no impact on its financial statements and the required disclosures are included in Note 6, "Fair Value of Financial Instruments."

In May 2009, the FASB issued guidance, “Subsequent Events,” which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Recognized subsequent events should be recognized in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not recognized in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This standard, which includes a required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. The bank adopted this standard in the second quarter and the required disclosures are included in Note 9, “Subsequent Events.”

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 and its affiliated associations (district), are 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, 2009, the bank provided financing to 19 district associations and certain other financing institutions.

NOTE 2 — INVESTMENTS

Available for Sale

A summary of the amortized cost and fair value of investment securities available for sale, excluding mission-related and other investments, at September 30, 2009 is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Corporate debt	\$ 232,045	\$ 2,073	\$ (5)	\$ 234,113	1.12 %
Federal agency collateralized mortgage obligations	1,730,243	40,058	(4,421)	1,765,880	3.57
Other collateralized mortgage obligations	139,256	24	(13,654)	125,626	5.73
Asset-backed securities	37,350	-	(3,938)	33,412	3.79
Total available-for-sale investments	<u>\$ 2,138,894</u>	<u>\$ 42,155</u>	<u>\$ (22,018)</u>	<u>\$ 2,159,031</u>	<u>3.47 %</u>

The following table is a summary of the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at September 30, 2009:

	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years	Total
Corporate debt	\$ 130,085	\$ 104,028	\$ -	\$ -	\$ 234,113
Federal agency collateralized mortgage obligations	-	121,779	331,558	1,312,543	1,765,880
Other collateralized mortgage obligations	-	-	13,133	112,493	125,626
Asset-backed securities	-	5,011	7,141	21,260	33,412
Total fair value	<u>\$ 130,085</u>	<u>\$ 230,818</u>	<u>\$ 351,832</u>	<u>\$ 1,446,296</u>	<u>\$ 2,159,031</u>
Total amortized cost	\$ 130,000	\$ 224,770	\$ 347,824	\$ 1,436,300	\$ 2,138,894
Weighted average yield	0.35%	3.70%	3.05%	3.81%	3.47%

Mission-Related and Other Held-to-Maturity Investments

The bank's held-to-maturity investments consisted of mission-related investment securities with contractual maturities greater than 10 years. A summary of the amortized cost and fair value of mission-related and other held-to-maturity investment securities at September 30, 2009 is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Mission-related securities due after 10 years	\$ 41,354	\$ 1,777	\$ -	\$ 43,131	5.19 %

Investments Available for Sale

The following table shows investments by gross unrealized losses and fair value, aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position at September 30, 2009. The continuous loss position is based on the date the impairment was first identified:

	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt	\$ -	\$ -	\$ 29,995	\$ (5)	\$ 29,995	\$ (5)
Federal agency collateralized mortgage obligations	276,490	(4,001)	96,042	(5,623)	372,532	(9,624)
Other collateralized mortgage obligations	200	(1)	90,513	(8,450)	90,713	(8,451)
Asset-backed securities	-	-	33,412	(3,938)	33,412	(3,938)
Total	<u>\$ 276,690</u>	<u>\$ (4,002)</u>	<u>\$ 249,962</u>	<u>\$ (18,016)</u>	<u>\$ 526,652</u>	<u>\$ (22,018)</u>

The bank evaluates investment securities for other-than-temporary impairment on a quarterly basis. Factors considered in determining whether an impairment is other than temporary include: 1) the length of time and the extent to which the fair value is less than cost, 2) the financial condition and near-term prospects of the issuer, 3) the estimated cash flow projections compared to contractual cash flows and 4) significant rating agency changes.

The bank recognized other-than-temporary impairment losses on four mortgage-backed investments during the first nine months of 2009. The credit portion of the impairment losses, totaling \$3,017 for the first nine months of 2009, was recognized as a loss in earnings of \$1,361 in the first quarter, \$977 in the second quarter, and \$679 in the third quarter. The non-credit-related impairment losses on the four investments, totaling \$5,204, are included as a charge against other comprehensive income. Also, in accordance with guidance issued in 2009, \$1,527 in non-credit-related impairment losses taken as a charge against earnings during 2008 was added back to retained earnings and charged against accumulated other comprehensive income during the first quarter of 2009.

As the bank has no intent of selling the securities deemed other-than-temporarily impaired (OTTI) and will not more likely than not be required to sell the securities before recovery, the credit loss portion of impairment was recognized through earnings for the first nine months of 2009. To measure the amount related to credit loss in the determination of OTTI, the bank utilizes a third party vendor's services for cash flow modeling and projection of credit losses for specific non-agency residential mortgage-backed securities and subprime asset-backed securities. Applicable securities are identified through prior analysis based on the deterioration of price and credit ratings. Significant inputs utilized in the methodology of the modeling include assumptions surrounding market data (interest rates and home prices) and the applicable securities' loan level data. Loan level data evaluated includes loan status, coupon and resets, FICO scores, loan-to-value, geography, property type, etc. Loan level data is then combined with assumptions surrounding future behavior of home prices, prepayment rates, default rates and loss severity to arrive at cash flow projections for the underlying collateral. The present value of these cash flow projections is then evaluated against the specific security's structure and credit enhancement to determine if the bond will absorb losses.

The following is a rollforward of the amount related to credit losses recognized during the nine months ended September 30, 2009:

Credit losses for which a portion of an other-than-temporary impairment was recognized in OCI at December 31, 2008	\$ 712
Additions for the amount related to credit loss for which other-than-temporary impairment was not previously recognized	1,890
Increases to amount related to credit loss for which other-than-temporary impairment previously recognized when it did not intend to sell and it is not more likely than not that it will be required to sell	<u>1,127</u>
Credit losses for which a portion of an other-than-temporary impairment was recognized in OCI at September 30, 2009	<u><u>\$ 3,729</u></u>

NOTE 3 — ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	Nine Months Ended September 30,	
	2009	2008
Balance at beginning of period	\$ 12,549	\$ 1,065
Provision for loan losses	32,656	10,745
Loans charged off	(8,178)	-
Recoveries	518	225
Change in reserve for unfunded commitments	121	-
Balance at end of period	<u><u>\$ 37,666</u></u>	<u><u>\$ 12,035</u></u>

At September 30, 2009, impaired loans of \$92.4 million had a related specific allowance of \$33.8 million, while the remaining \$111.3 million of impaired loans had no related specific allowance as a result of adequate collateralization. Charge-offs included \$4.7 million in charge-offs against loans to two telecommunications borrowers.

The average recorded investment in impaired loans for the nine months ended September 30, 2009 and 2008, were \$128.6 million and \$24.6 million, respectively. The bank recognized interest income of \$425 on impaired loans during the nine months ended September 30, 2009.

NOTE 4 — 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, 2009, were approximately \$177.2 billion.

NOTE 5 — FAIR VALUE MEASUREMENTS

Accounting guidance 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 2, “Summary of Significant Accounting Policies” of the 2008 Annual Report for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at September 30, 2009				
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Total			
Assets:				
Federal funds	\$ 20,338	\$ -	\$ 20,338	\$ -
Investments available for sale	2,159,030	-	2,127,768	31,262
Derivative assets	985	-	985	-
Assets held in nonqualified benefit trusts	215	215	-	-
Total	<u>\$ 2,180,568</u>	<u>\$ 215</u>	<u>\$ 2,149,091</u>	<u>\$ 31,262</u>
Liabilities:				
Derivative liabilities	\$ 48	\$ -	\$ 48	\$ -
Standby letters of credit	1,901	-	1,901	-
Total	<u>\$ 1,949</u>	<u>\$ -</u>	<u>\$ 1,949</u>	<u>\$ -</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, 2009, to September 30, 2009:

Available-for-sale investment securities:

Balance at January 1, 2009	\$ 99,992
Net losses included in other comprehensive income	(376)
Net losses included in earnings	(3,017)
Purchases, issuances and settlements, net	(104,208)
Transfers out of Level 3	38,871
Balance at September 30, 2009	<u>\$ 31,262</u>

The net losses included in other comprehensive income in the above table are all on securities held at September 30, 2009.

Assets and liabilities measured at fair value on a nonrecurring basis at September 30, 2009 for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurement at September 30, 2009			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans	\$ 52,331	\$ -	\$ -	\$ 52,331
Total assets	\$ 52,331	\$ -	\$ -	\$ 52,331

Valuation Techniques

As more fully discussed in Note 2, “Summary of Significant Accounting Policies,” of the Annual Report, accounting guidance 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 is 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, 2009, include certain mortgage-backed securities.

Assets Held in Nonqualified Benefits Trusts

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

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.

Loans

For certain loans evaluated for impairment, the fair value is based upon the underlying collateral since the loans were collateral-dependent loans for which real estate is the collateral. These loans are generally classified as Level 3.

NOTE 6 — FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated values of the bank's financial instruments at September 30, 2009 and December 31, 2008.

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

	September 30, 2009		December 31, 2008	
	Carrying		Carrying	
	Amount	Fair Value	Amount	Fair Value
Financial assets				
Cash, federal funds sold, securities purchased under resale agreements and investment securities	\$ 2,530,706	\$ 2,532,484	\$ 3,218,259	\$ 3,219,362
Loans	11,330,155	11,529,749	11,403,113	11,612,380
Allowance for loan losses	(37,666)	—	(12,549)	—
Loans, net	11,292,489	11,529,749	11,390,564	11,612,380
Derivative assets	985	985	31,439	31,439
Financial liabilities				
Bonds and notes	13,034,888	13,217,670	13,802,205	14,084,236
Subordinated debt	50,000	52,184	50,000	56,168
Derivative liabilities	48	48	3,074	3,074

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

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

The carrying value is a reasonable estimate of fair value.

Investment securities:

If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, the fair value is determined as described in Note 5, "Fair Value Measurements."

Loans:

Because no active market exists for the bank's loans, fair value is estimated by discounting the expected future cash flows using the bank's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the bank's loan rates as well as on management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows and discount rates reflecting appropriate credit risk are determined separately for each individual pool.

Fair value of loans in a nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher discount rates to reflect the uncertainty of continued cash flows. For noncurrent nonaccrual loans, it is assumed that collection will result only from the disposition of the underlying collateral. Fair value of these loans is estimated to equal the aggregate net realizable

value of the underlying collateral, discounted at an interest rate that appropriately reflects the uncertainty of the expected future cash flows over the average disposal period.

Bonds and Notes:

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

Subordinated Debt:

The fair value of these obligations is determined by discounting expected future cash flows based on the Treasury yield curve.

Derivative Assets and Liabilities:

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

Commitments to Extend Credit:

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

NOTE 7 — DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Effective January 1, 2009, the bank adopted accounting guidance, “Disclosures about Derivative Instruments and Hedging Activities,” which amends and expands previous disclosure requirements for derivative instruments and for hedging activities.

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

The bank enters into derivative transactions, particularly interest rate swaps, to lower funding costs, diversify sources of funding, alter interest rate exposures arising from mismatches between assets and liabilities, or better manage liquidity. Interest rate swaps allow the bank to raise long-term borrowings at fixed rates and swap them into floating rates to better match the repricing characteristics of earning assets. Under interest rate swap arrangements, the bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating-rate index.

A substantial amount of the bank's assets are interest-earning assets (principally loans and investments) that tend to be medium-term floating-rate instruments. In order to match the asset structure, interest rate swaps in which a bank pays the floating rate and receives the fixed rate (receive fixed swaps) are used to reduce the impact of market fluctuations on the bank's net interest income. Because the size of swap positions needed to reduce the impact of market fluctuations varies over time, a bank also enters into swaps in which it receives the floating rate and pays the fixed rate (pay fixed swaps) when necessary to reduce its net position.

The bank may purchase interest rate options, such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on its floating-rate assets. The primary types of derivative instruments used and the amount of activity during the period is summarized in the following table:

	Received-Fixed Swaps	Pay-Fixed Swaps	Total
Balance at January 1, 2009	\$ 350,000	\$ 450,000	\$ 800,000
Additions	125,000	-	125,000
Terminations	(350,000)	(450,000)	(800,000)
Balance at September 30, 2009	\$ 125,000	\$ -	\$ 125,000

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

To minimize the risk of credit losses, the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing and levels of exposure to individual counterparties. The bank does not anticipate nonperformance by any of these counterparties. The bank typically enters into master agreements that contain netting provisions. These provisions allow the bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. However, derivative contracts must be reflected in the financial statements on a gross basis regardless of the netting agreement. Another way the bank minimizes the risk of credit losses from derivatives is that substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to the other one are reached, which thresholds may vary depending on the counterparty's credit rating. At September 30, 2009, and December 31, 2008, the bank's exposure to counterparties, net of collateral, was \$1.4 million and \$32.1 million, respectively. At September 30, 2009 and December 31, 2008, the bank had posted no securities as collateral. At December 31, 2008, the bank held cash collateral of \$1.1 million with respect to its obligations under these arrangements.

The bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the ALCO's oversight of the bank's asset/liability and treasury functions. The bank's ALCO is responsible for approving hedging strategies that are developed within parameters established by the bank's board of directors through the bank's analysis of data derived from financial simulation models

and other internal and industry sources. The resulting hedging strategies are then incorporated into the bank's overall interest rate risk-management strategies. The bank held no derivatives that were not designated as hedges at September 30, 2009, or December 31, 2008.

Fair Value Hedges

The bank's derivative instruments that are designated and qualify as a fair value hedge all meet the standards for accounting treatment that presume full effectiveness. Accordingly, no gain or loss is recognized in earnings.

Cash Flow Hedges

The bank's derivative instruments that are designated and qualify as a cash flow hedge all meet the standards for accounting treatment that presume full effectiveness. Thus, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income.

Derivatives designated as hedging instruments	Balance Sheet Location	Fair Value 9/30/2009	Fair Value 12/31/2008	Balance Sheet Location	Fair Value 9/30/2009	Fair Value 12/31/2008
Receive fixed	Other assets	\$ 985	\$ 31,439			
Receive fixed				Other liabilities	\$ 48	\$ 3,074

Derivatives designated as hedging instruments	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)
Pay fixed	\$ 3,073

NOTE 8 — 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:

	Supplemental Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Service cost	\$ 67	\$ 305	\$ 145	\$ 126
Interest cost	238	409	329	310
Amortization of prior service costs	266	265	(225)	(229)
Amortization of net loss	146	38	-	(4)
Net periodic benefit cost	<u>\$ 717</u>	<u>\$ 1,017</u>	<u>\$ 249</u>	<u>\$ 203</u>

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 9 — SUBSEQUENT EVENTS

The bank has evaluated subsequent events through November 9, 2009, which is the date the financial statements were issued.

For the quarter ended September 30, 2009, the Farm Credit Bank of Texas, effective November 9, 2009, was placed into the “Category I” designation of the Amended and Restated Market Access Agreement (MAA), as a result of the district falling below a defined Amended and Restated Contractual Interbank Performance Agreement (CIPA) score standard. The district’s CIPA score dropped principally as a result of increases in adversely classified assets, including nonperforming assets. Although the nonperforming assets of the district have increased over the last several quarters, as has been the case generally with most other financial institutions, the district continued to achieve healthy earnings and maintain relatively strong capital levels. (See the Management’s Discussion and Analysis, “Structural Risk Management,” of the 2008 Annual Report to shareholders for additional information about the MAA and the CIPA.)

Under the MAA, once a System bank is placed in “Category I,” a committee of representatives from the System banks and Funding Corporation (Committee) is formed within seven days after receiving notice of noncompliance by the System bank. Within 30 days of receiving a notice, the System bank in “Category I” is required to provide to the Committee certain information, including (a) a detailed explanation of the causes of the System bank being in “Category I,” (b) an action plan to improve the System bank’s financial situation so that it is no longer in “Category I,” (c) a timetable for achieving that result, and (d) certain financial information, such as a business plan and external auditor reports. In addition, periodic updates are provided to the Committee regarding certain bank financial information and credit quality indicators as well as certain regulatory information. No economic penalties are associated with being placed into “Category I.”

A System bank exits “Category I” by returning to compliance with each of the agreed-upon standards under the MAA. The Farm Credit Bank of Texas is developing a plan to address and reduce the district’s nonperforming assets. This plan contemplates the district will sufficiently reduce its nonperforming loans to allow the Farm Credit Bank of Texas to exit “Category I” and return to being in compliance with the MAA.

There are no other significant subsequent events requiring disclosure as of November 9, 2009.

NOTE 10 — 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, 2009	December 31, 2008
Cash	\$ 12,682	43,789
Investment securities	29,009	17,929
Loans	13,488,084	13,468,746
Less allowance for loan losses	90,321	39,104
Net loans	13,397,763	13,429,642
Accrued interest receivable	193,698	173,210
Other property owned, net	50,524	6,495
Other assets	311,412	293,655
Total assets	\$ 13,995,088	\$ 13,964,720
Bonds and notes	\$ 11,871,807	\$ 11,782,402
Other liabilities	128,652	248,596
Total liabilities	12,000,459	12,030,998
Capital stock and participation certificates	64,149	64,619
Retained earnings	1,922,916	1,860,481
Accumulated other comprehensive income	7,564	8,622
Total members' equity	1,994,629	1,933,722
Total liabilities and members' equity	\$ 13,995,088	\$ 13,964,720

Statement of income data	Nine Months Ended September 30,	
	2009	2008
Interest income	\$ 571,131	\$ 636,692
Interest expense	298,566	373,158
Net interest income	272,565	263,534
Provision for loan losses	104,209	16,759
Net interest income after provision for loan losses	168,356	246,775
Noninterest income	43,759	53,594
Other expense	137,556	127,267
(Benefit from) provision for income taxes	(906)	355
Net income	\$ 75,465	\$ 172,747