

**PANHANDLE-PLAINS LAND BANK, FLCA**

---

**2009  
Quarterly Report  
Third Quarter**



**For the Quarter Ended September 30, 2009**

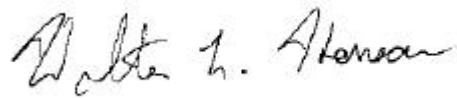
## REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate and complete to the best of his or her knowledge and belief.



Robert R. Williams, Jr., Chief Executive Officer

*October 30, 2009*



Walter L. Henson, Chairman, Board of Directors

*October 30, 2009*



Cathy D. Scribner, Chief Financial Officer

*October 30, 2009*

## **PANHANDLE-PLAINS LAND BANK, FLCA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Panhandle-Plains Land Bank, FLCA (Federal Land Credit Association), referred to as the Association, for the quarter and nine months ended September 30, 2009. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2008 Annual Report of the Association.

The association 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.

Throughout the second and third quarter of 2009, the national economy, as well as the global economy, was in the midst of a significant recession. The Association is not immune from the impact of this recession. High risk assets have increased substantially during 2009 and year to date earnings have been significantly reduced. Even though the credit quality of the loan portfolio has trended downward, the Association's financial position remains strong. The Association continues to monitor its underwriting standards so as to be actively involved in extending new credit while effectively managing the risk in its loan portfolio. The Association meets the required FCA regulatory permanent capital ratios for the nine month period ending September 30, 2009. See Loan Portfolio, Results of Operations, and Note 2 Allowance for Loan Losses for further explanation.

The financial statements were prepared under the oversight of the Association's audit committee.

### **Loan Portfolio:**

Total loans outstanding at September 30, 2009, including nonaccrual loans, were \$374,235,491 compared to \$373,106,244 at December 31, 2008, reflecting an increase of 0.3 percent. This slow growth pattern was expected because of recessionary pressures and the implementation of more restrictive lending practices. The table under Note 2 of this statement illustrates the Association's components and trends of high-risk assets. Nonaccrual loans as a percentage of total loans outstanding were 3.3 percent at September 30, 2009, compared to 1.1 percent at December 31, 2008. This Association experienced an increase in nonaccrual loans during the third quarter of 2009. This increase in nonaccrual loans primarily came from customers involved in the operation of ethanol plants and customers that produce income from marketing timber and real estate. The adverse economic factors worked against these types of customers and decreased their repayment capacity while reducing the value of assets pledged as collateral. Because of their inability to service debt, these loans were moved to nonaccrual. The Association had no acquired property as of September 30, 2009. The major commodity concentration within the Association's loan volume was livestock, wheat and cotton.

The Association recorded no recoveries and \$637,149 in charge-offs for the quarter ending September 30, 2009, and no recoveries or charge-offs for the same period in 2008. The Association's allowance for loan losses was 1.0 percent and 0.1 percent of total loans outstanding as of September 30, 2009, and December 31, 2008, respectively.

Six participation loans were downgraded during the third quarter with two of these participation loans moving to nonaccrual. One of the nonaccrual participation loans required a specific reserve of \$71,425, an interest reversal of \$26,741 and a charge off of \$637,149. This charge off was based on a current appraisal. The other participation loan moved to nonaccrual required a specific reserve of \$250,000 and an interest reversal of \$2,802. These downgrades led to an increase in the provision of losses for the third quarter of \$1,118,726 compared to 87,830 for the same period of 2008. While these events have substantially reduced the association's net earnings for the quarter, the association has weathered these events and remains strong with a good credit quality and a strong capital position.

The overall credit quality of the loan portfolio remained strong through the third quarter of 2009.

**Risk Exposure:**

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

|   | <b>September 30, 2009</b> |               | December 31, 2008   |               |
|---|---------------------------|---------------|---------------------|---------------|
|   | <u>Amount</u>             | <u>%</u>      | <u>Amount</u>       | <u>%</u>      |
| Nonaccrual                                      | <u>\$ 12,300,488</u>      | <u>100.0%</u> | \$ 3,968,258        | 99.9%         |
| 90 days past due and still<br>accruing interest | -                         | 0.0%          | -                   | 0.0%          |
| Formally restructured                           | -                         | 0.0%          | 5,665               | 0.1%          |
| Other property owned, net                       | -                         | 0.0%          | -                   | 0.0%          |
| Total   | <u>\$ 12,300,488</u>      | <u>100.0%</u> | <u>\$ 3,973,923</u> | <u>100.0%</u> |

**Results of Operations:**

The Association had net income of \$378,547 and \$296,104 for the three and nine months ended September 30, 2009, as compared to net income of \$1,651,563 and \$4,448,110 for the same periods in 2008 reflecting a decrease of 77.1 and 93.3 percent, respectively. Net income for the quarter and nine months ended September 30, 2009 was severely impacted by provision for loan loss expense of \$1,118,726 and \$4,082,005, respectively. These amounts compare to \$87,830 and \$120,768 for the quarter and nine months ended September 30, 2008. The increase in the provision for loan losses is a result of the previously mentioned problems in the ethanol industry. Net interest income was \$2,228,857 and \$6,815,710, respectively, for the three and nine months ended September 30, 2009, compared to \$2,294,649 and \$6,610,647 for the same periods in 2008. The loan portfolio experienced an increased level of nonaccrual loans in 2009 which negatively impacted interest income and ultimately net interest income for the quarter and nine months ended September 30, 2009. Interest income for the first nine months of 2009 decreased by \$1,945,929 or 11.8 percent from the same periods of 2008, primarily due to a decrease in interest rates and an increased level of nonaccrual loans. Interest expense for the first nine months of 2009 decreased by \$2,150,992, or 21.8 percent, from the same periods of 2008 due to a decrease in interest rates. Average loan volume for the third quarter of 2009 was \$372,172,617, compared to \$369,775,329 in the third quarter of 2008. The average spread on the loan portfolio for the third quarter 2009 was 1.91 percent, compared to 1.89 percent in the third quarter of 2008.

The Association's noninterest income decreased from \$729,499 in the first nine months of 2008 to \$624,960 in the first nine months of 2009. This decrease is a result of the Association generating less loan fee income from new loan originations, participation fee income, and reduced bank stock investment income from FCBT.

The Association's noninterest expenses increased \$291,295 in the first nine months of 2009 as compared to the same time period in 2008. This increase is attributable to increases in the Association's pension plan funding and in Farm Credit System insurance premiums. Beginning in 2009, the Farm Credit System Insurance Corporation raised premiums on accrual volume from 15 basis points to 20 basis points. Contributions to the Association's defined benefit plan increased as deterioration in the stock market required additional funding to the plan.

The Association's return on average assets for the nine months ended September 30, 2009, was 0.10 and 1.60 percent for the same period in 2008. The Association's return on average equity for the nine months ended September 30, 2009, was 0.61 and 9.53 percent for the same period in 2008. These decreases are caused by lower net income in 2009 which is largely related to a decrease in earnings on own funds caused by lower interest rates, slightly higher operating costs, and additional provision for loan loss expenses as previously discussed.

**Liquidity and Funding Sources:**

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (The Bank), which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

|                                  | <b>September 30,<br/>2009</b> | December 31,<br>2008  |
|----------------------------------|-------------------------------|-----------------------|
| Note payable to the Bank         | \$ 318,422,633                | \$ 318,849,872        |
| Accrued interest on note payable | 841,195                       | 1,123,881             |
| Total                            | <b>\$ 319,263,828</b>         | <b>\$ 319,973,753</b> |

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. At September 30, 2009, the Association's liquidity ratio, as calculated according to the general financing agreement with the FCBT, was 17.02 percent, which exceeds the minimum requirement. Management is not aware of any conditions likely to restrict future funding needs.

**Capital Resources:**

The Association's capital position decreased by \$596,449 at September 30, 2009, compared to December 31, 2008. The Association's debt as a percentage of members' equity was 5.01:1 as of September 30, 2009, compared to 4.98:1 as of December 31, 2008.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at September 30, 2009, was 15.0 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at September 30, 2009, were 14.5 and 14.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

**Relationship with the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2008 Annual Report of Panhandle-Plains Land Bank, FLCA more fully describe the Association's relationship with the Bank.

The Tenth Farm Credit District's (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcf@farmcreditbank.com](mailto:fcf@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its web site at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Panhandle-Plains Land Bank, FLCA, P.O. Box 7785, Amarillo, TX 79114-7785 or calling (806) 353-6688. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [cathy.scribner@farmcreditbank.com](mailto:cathy.scribner@farmcreditbank.com). The Association makes its annual and quarterly stockholder reports available on its website at [www.panhandle-plainslandbank.com](http://www.panhandle-plainslandbank.com).

**PANHANDLE-PLAINS LAND BANK, FLCA**

**BALANCE SHEET**

|   | <b>September 30,<br/>2009<br/>(unaudited)</b> | <b>December 31,<br/>2008</b> |
|---|---|------------------------------|
| <b><u>ASSETS</u></b>                          |   |                              |
| Cash  | \$ 55,390                                     | \$ 2,793,572                 |
| Investments                                   | -   | -                            |
| Loans   | 374,235,491                                   | 373,106,244                  |
| Less: allowance for loan losses               | 3,869,390                                     | 361,206                      |
| Net loans                                     | <u>370,366,101</u>                            | <u>372,745,038</u>           |
| Accrued interest receivable                   | 8,507,034                                     | 5,448,667                    |
| Investment in and receivable from the Bank:   |   |                              |
| Capital stock                                 | 6,128,200                                     | 6,128,200                    |
| Other   | -   | -                            |
| Other property owned, net                     | -   | -                            |
| Premises and equipment                        | 683,778                                       | 700,813                      |
| Other assets                                  | 254,119                                       | 60,796                       |
| Total assets                                  | <u><u>\$ 385,994,622</u></u>                  | <u><u>\$ 387,877,086</u></u> |
| <b><u>LIABILITIES</u></b>                     |   |                              |
| Note payable to the Bank                      | \$ 318,422,633                                | \$ 318,849,872               |
| Accrued interest payable                      | 841,195                                       | 1,123,881                    |
| Drafts outstanding                            | 1,156,088                                     | 1,491,187                    |
| Dividends Payable                             | -   | 250,000                      |
| Patronage distributions payable               | -   | -                            |
| Other liabilities                             | 1,317,123                                     | 1,308,114                    |
| Total liabilities                             | <u><u>321,737,039</u></u>                     | <u><u>323,023,054</u></u>    |
| <b><u>MEMBERS' EQUITY</u></b>                 |   |                              |
| Capital stock and participation certificates  | 1,744,415                                     | 1,754,805                    |
| Allocated retained earnings                   | -   | -                            |
| Unallocated retained earnings                 | 62,318,066                                    | 62,886,962                   |
| Accumulated other comprehensive income (loss) | 195,102                                       | 212,265                      |
| Total members' equity                         | <u><u>64,257,583</u></u>                      | <u><u>64,854,032</u></u>     |
| Total liabilities and members' equity         | <u><u>\$ 385,994,622</u></u>                  | <u><u>\$ 387,877,086</u></u> |

PANHANDLE-PLAINS LAND BANK, FLCA

STATEMENT OF INCOME

(unaudited)

|  | Quarter Ended<br>September 30, |              | Nine Months Ended<br>September 30, |               |
|--|--------------------------------|--------------|------------------------------------|---------------|
|  | 2009                           | 2008         | 2009                               | 2008          |
| <b><u>INTEREST INCOME</u></b>                          |                                |              |                                    |               |
| Loans  | \$ 4,764,201                   | \$ 5,531,752 | \$ 14,553,403                      | \$ 16,499,331 |
| Investments  | -                              | -            | -                                  | -             |
| Other  | -                              | -            | -                                  | -             |
| Total interest income                                  | <b>4,764,201</b>               | 5,531,752    | <b>14,553,403</b>                  | 16,499,331    |
| <b><u>INTEREST EXPENSE</u></b>                         |                                |              |                                    |               |
| Note payable to the Bank                               | <b>2,535,344</b>               | 3,237,103    | <b>7,737,692</b>                   | 9,888,684     |
| Total interest expense                                 | <b>2,535,344</b>               | 3,237,103    | <b>7,737,692</b>                   | 9,888,684     |
| Net interest income                                    | <b>2,228,857</b>               | 2,294,649    | <b>6,815,711</b>                   | 6,610,647     |
| <b><u>PROVISION FOR LOSSES</u></b>                     |                                |              |                                    |               |
| Provision (negative provision) for loan losses         | <b>1,118,726</b>               | 87,830       | <b>4,082,005</b>                   | 120,768       |
| Provision for acquired property losses                 | -                              | -            | -                                  | -             |
| Net interest income after<br>provision for loan losses | <b>1,110,131</b>               | 2,206,819    | <b>2,733,706</b>                   | 6,489,879     |
| <b><u>NONINTEREST INCOME</u></b>                       |                                |              |                                    |               |
| Income from the bank:                                  |                                |              |                                    |               |
| Patronage income                                       | <b>48,118</b>                  | 53,684       | <b>147,515</b>                     | 170,806       |
| Loan fees  | <b>102,356</b>                 | 137,527      | <b>440,470</b>                     | 526,488       |
| Financially related services income                    | <b>3,869</b>                   | 2,583        | <b>13,669</b>                      | 11,405        |
| Gain (loss) on other property owned, net               | -                              | -            | -                                  | -             |
| Gain (loss) on sale of premises and equipment, net     | -                              | -            | -                                  | -             |
| Other noninterest income                               | <b>1,357</b>                   | 1,624        | <b>23,306</b>                      | 20,800        |
| Total noninterest income                               | <b>155,700</b>                 | 195,418      | <b>624,960</b>                     | 729,499       |
| <b><u>NONINTEREST EXPENSES</u></b>                     |                                |              |                                    |               |
| Salaries and employee benefits                         | <b>505,327</b>                 | 396,880      | <b>1,813,175</b>                   | 1,572,482     |
| Directors' expense                                     | <b>21,447</b>                  | 21,827       | <b>138,388</b>                     | 123,935       |
| Purchased services                                     | <b>76,998</b>                  | 82,740       | <b>213,949</b>                     | 255,554       |
| Travel   | <b>19,016</b>                  | 21,733       | <b>53,922</b>                      | 68,294        |
| Occupancy and equipment                                | <b>23,396</b>                  | 27,187       | <b>74,618</b>                      | 80,203        |
| Communications   | <b>4,008</b>                   | 6,221        | <b>14,435</b>                      | 15,952        |
| Advertising  | <b>19,258</b>                  | 15,808       | <b>65,702</b>                      | 69,325        |
| Public and member relations                            | <b>13,928</b>                  | 10,548       | <b>52,105</b>                      | 48,540        |
| Supervisory and exam expense                           | <b>36,479</b>                  | 33,256       | <b>102,989</b>                     | 93,573        |
| Insurance Fund premiums                                | <b>154,305</b>                 | 115,740      | <b>457,781</b>                     | 376,490       |
| Merger-implementation and restructuring costs          | -                              | -            | -                                  | -             |
| Other noninterest expense                              | <b>13,122</b>                  | 18,734       | <b>75,498</b>                      | 66,919        |
| Total noninterest expenses                             | <b>887,284</b>                 | 750,674      | <b>3,062,562</b>                   | 2,771,267     |
| Net income   | <b>\$ 378,547</b>              | \$ 1,651,563 | <b>\$ 296,104</b>                  | \$ 4,448,111  |

PANHANDLE-PLAINS LAND BANK, FLCA

STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

|   | Capital Stock/<br>Participation<br>Certificates | Retained Earnings  |                             | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Members'<br>Equity |
|---|---|--------------------|-----------------------------|--|-----------------------------|
|   |   | Allocated          | Unallocated                 |  |                             |
| Balance at December 31, 2007  | \$ 1,745,090                                    | \$ -               | \$ 58,177,577               | \$ 267,640   | \$ 60,190,307               |
| Adjustment to beginning balance due to<br>FAS No. 158 accounting change             | -   | -                  | (11,099)                    | -  | (11,099)                    |
| Balance at January 1, 2008  | 1,745,090                                       | -                  | 58,166,478                  | 267,640  | 60,179,208                  |
| Comprehensive income  |   |                    |                             |  |                             |
| Net income  | -   | -                  | 4,448,111                   | -  | 4,448,111                   |
| Change in unrealized gains (losses) on<br>investment securities                     | -   | -                  | -                           | -  | -                           |
| Amortization of costs included in<br>periodic retirement benefit costs              | -   | -                  | -                           | -  | -                           |
| Total comprehensive income  | -   | -                  | 4,448,111                   | -  | 4,448,111                   |
| Capital stock/participation certificates<br>issued                                  | 194,275   | -                  | -                           | -  | 194,275                     |
| Capital stock/participation certificates<br>and allocated retained earnings retired | (173,615)                                       | -                  | -                           | -  | (173,615)                   |
| Stock equalization  | -   | -                  | -                           | -  | -                           |
| Dividends declared  | -   | -                  | -                           | -  | -                           |
| Patronage refunds:  |   |                    |                             |  |                             |
| Cash  | -   | -                  | -                           | -  | -                           |
| Capital stock/participation certificates<br>and allocated retained earnings         | -   | -                  | -                           | -  | -                           |
| Balance at September 30, 2008   | <u>\$ 1,765,750</u>                             | <u>\$ -</u>        | <u>\$ 62,614,589</u>        | <u>\$ 267,640</u>                                      | <u>\$ 64,647,979</u>        |
| Balance at December 31, 2008  | \$ 1,754,805                                    | \$ -               | \$ 62,886,962               | \$ 212,265   | \$ 64,854,032               |
| Comprehensive income  |   |                    |                             |  |                             |
| Net income  | -   | -                  | 296,104                     | -  | 296,104                     |
| Change in unrealized gains (losses) on<br>investment securities                     | -   | -                  | -                           | -  | -                           |
| Amortization of costs included in<br>periodic retirement benefit costs              | -   | -                  | -                           | (17,163)   | (17,163)                    |
| Total comprehensive income  | -   | -                  | 296,104                     | (17,163)   | 278,941                     |
| Capital stock/participation certificates<br>issued                                  | 123,300   | -                  | -                           | -  | 123,300                     |
| Capital stock/participation certificates<br>and allocated retained earnings retired | (133,690)                                       | -                  | -                           | -  | (133,690)                   |
| Stock equalization  | -   | -                  | -                           | -  | -                           |
| Dividends declared  | -   | -                  | -                           | -  | -                           |
| Patronage refunds:  |   |                    |                             |  |                             |
| Cash  | -   | -                  | (865,000)                   | -  | (865,000)                   |
| Capital stock/participation certificates<br>and allocated retained earnings         | -   | -                  | -                           | -  | -                           |
| <b>Balance at September 30, 2009</b>  | <u><b>\$ 1,744,415</b></u>                      | <u><b>\$ -</b></u> | <u><b>\$ 62,318,066</b></u> | <u><b>\$ 195,102</b></u>                               | <u><b>\$ 64,257,583</b></u> |

**PANHANDLE-PLAINS LAND BANK, FLCA**  
**NOTES TO THE FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

The Panhandle-Plains Land Bank, FLCA (Federal Land Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the Armstrong, Briscoe, Carson, Floyd, Gray, Hale, southwest portion of Hall, Hansford, Hemphill, Hutchinson, Lipscomb, Motley, Ochilree, Oldham, Randall and Roberts counties of the State of Texas. A description of the organization and operations of the Panhandle-Plains Land Bank, FLCA (Federal Land Credit Association), referred to as the Association, the significant accounting policies followed, and the financial condition and results of operations as of December 31, 2008 are contained in the 2008 Annual Report to stockholders. These unaudited third quarter 2009 financial statements should be read in conjunction with the 2008 Annual Report to Stockholders. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

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

In April 2009, the FASB issued 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". The 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 is effective for interim periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. Revisions resulting from a change in valuation techniques or their application are accounted for as a change in accounting estimate. The Association adopted the guidance in second quarter 2009. The adoption did not have a material impact on the financial condition or results of operations of the Association.

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. The Association held no investments in debt securities during the first nine months of 2009.

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. There are two types of subsequent events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). 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 guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was effective for interim or annual periods ending after June 15, 2009.

The accompanying financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these financial statements.

The preparation of these financial statements requires the use of management's estimates. The results for the quarter and the nine months ended September 30, 2009, are not necessarily indicative of the results to be expected for the year ended December 31, 2009. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. An analysis of the allowance for loan losses follows:

|                                 | <b>September 30,<br/>2009</b> | September 30,<br>2008 |
|---------------------------------|-------------------------------|-----------------------|
| Balance at beginning of quarter | \$ 3,387,813                  | \$ 208,685            |
| Provision for loan losses       | 1,118,726                     | 87,830                |
| Charge-offs                     | (637,149)                     | -                     |
| Recoveries                      | -                             | -                     |
| Balance at end of quarter       | <u>\$ 3,869,390</u>           | <u>\$ 296,515</u>     |

The following table presents information concerning impaired loans:

|   | <b>September 30,<br/>2009</b> | September 30,<br>2008 |
|---|-------------------------------|-----------------------|
| Impaired loans with related allowance             | \$ 8,464,762                  | \$ -                  |
| Impaired loans with no related allowance          | 3,835,726                     | 115,428               |
| Total impaired loans                              | <u>\$ 12,300,488</u>          | <u>\$ 115,428</u>     |
| Allowance on impaired loans                       | \$ 2,984,342                  | \$ -                  |
| Average impaired loans                            | \$ 10,530,488                 | \$ 116,000            |
| Interest income on impaired loans for the quarter | \$ 4,469                      | \$ 5,660              |

## NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

#### NOTE 4 — FAIR VALUE MEASUREMENTS:

Authoritative 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 11 to the 2008 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a non-recurring basis at September 30, 2009 for each of the fair value hierarchy values are summarized below:

|                      | Fair Value Measurement Using |         |              | Total Fair Value | Total Gains (losses) |
|----------------------|------------------------------|---------|--------------|------------------|----------------------|
|                      | Level 1                      | Level 2 | Level 3      |                  |                      |
| Assets:              |                              |         |              |                  |                      |
| Loans *              | \$ -                         | \$ -    | \$ 5,480,419 | \$ 5,480,419     | \$ -                 |
| Other property owned | -                            | -       | -            | -                | -                    |

\* Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance, “Accounting by Creditors for Impairment of a Loan”. The fair value was based upon the underlying collateral since these were collateral dependent loans for which real estate is the collateral.

#### Valuation Techniques

As more fully discussed in Note 11 to the 2008 Annual Report to Stockholders, authoritative 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 and its related Associations’ assets and liabilities. For a more complete description, see Notes to the 2008 Annual Report.

##### *Loans*

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were collateral dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management’s knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a results, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

##### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value. Cost to sell represent transaction costs and are not included as a component of the assets fair value.

#### NOTE 5 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs for the nine months ended September 30, :

|                                     | Other Benefits |           |
|-------------------------------------|----------------|-----------|
|                                     | 2009           | 2008      |
| Service cost                        | \$ 23,352      | \$ 20,640 |
| Interest cost                       | 33,195         | 29,790    |
| Expected return on plan assets      | -              | -         |
| Amortization of prior service costs | (17,163)       | (17,499)  |
| Amortizations of net (gain) loss    | -              | 366       |
| Net periodic benefit cost           | \$ 39,384      | \$ 33,297 |

The Association previously disclosed in its financial statements for the year ended December 31, 2008, that it expected to contribute \$581,968 to its defined pension plan in 2009. As of September 30, 2009, \$436,476 of contributions have been made. The Association presently anticipates contributing an additional \$145,492 to fund its defined pension plan in 2009 for a total \$581,968.

**NOTE 7 — Subsequent Events:**

The Association has evaluated subsequent events through October 30, 2009 which is the date the financial statements were available to be issued and has determined there are no subsequent events to report.