



AG CREDIT

OF SOUTH TEXAS

2008 ANNUAL REPORT

December 31, 2008



Part of the Farm Credit System

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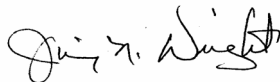
REPORT OF MANAGEMENT

The consolidated financial statements of AgCredit of South Texas, ACA (Association) are prepared by management, who is responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The Audit Committee of the board of directors has overall responsibility for the Association's systems of internal control and financial reporting. The Audit Committee consults regularly with management and reviews the results of the audits and examinations referred to previously.

The undersigned certify that this annual report has been reviewed and 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 their knowledge or belief.



Jimmy N. Wright, Chief Executive Officer

May 28, 2009



Bob Ed Stewart, Chairman, Board of Directors

May 28, 2009



Keith Ibrom, Chief Financial Officer

May 28, 2009

REPORT OF AUDIT COMMITTEE

The Audit Committee (Committee) is composed of the entire board of directors of AgCredit of South Texas, ACA (Association). In 2008, 13 committee meetings were held. The Committee oversees the scope of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on the Association's Web site. The Committee approved the appointment of PricewaterhouseCoopers LLP for 2008.

Management is responsible for the Association's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the Committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of the Association's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The Committee's responsibilities include monitoring and overseeing the processes.

In this context, the Committee reviewed and discussed the Association's audited consolidated financial statements for the year ended December 31, 2008 (audited consolidated financial statements) with management and PricewaterhouseCoopers LLP. The Committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communication With Those Charged With Governance), and both PricewaterhouseCoopers LLP and the Association's internal auditors directly provide reports on significant matters to the Committee.

The Committee discussed with PricewaterhouseCoopers LLP its independence from the Association. The Committee also reviewed the non-audit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The Committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the Committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the board of directors include the audited consolidated financial statements in the Association's Annual Report to Stockholders for the year ended December 31, 2008.

Audit Committee Members

Randy Rolando, Chairman
Bob Ed Stewart
Jack Harbison, Jr.
Billie Mack Simpson
William Barfield

May 28, 2009

AGCREDIT OF SOUTH TEXAS, ACA

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
	2008	2007	2006	2005	2004
<u>Balance Sheet Data</u>					
<u>Assets</u>					
Cash	\$ 1,751	\$ 247	\$ 547	\$ 138	\$ -
Loans	146,149	134,325	121,300	104,178	77,800
Less: allowance for loan losses	5,006	148	270	158	100
Net loans	141,143	134,177	121,030	104,020	77,700
Investment in and receivable from the Bank	2,629	2,407	1,953	1,484	1,484
Other property owned, net	1,693	-	-	-	-
Other assets	3,547	3,961	3,593	2,738	2,573
Total assets	<u>\$ 150,763</u>	<u>\$ 140,792</u>	<u>\$ 127,123</u>	<u>\$ 108,380</u>	<u>\$ 81,757</u>
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 2,647	\$ 3,268	\$ 2,514	\$ 1,286	\$ 1,633
Obligations with maturities greater than one year	136,704	122,503	110,820	94,490	67,995
Total liabilities	<u>139,351</u>	<u>125,771</u>	<u>113,334</u>	<u>95,776</u>	<u>69,628</u>
<u>Members' Equity</u>					
Capital stock and participation certificates	513	437	383	349	1,293
Allocated retained earnings	2,332	2,332	1,151	-	-
Unallocated retained earnings	8,567	12,254	12,255	12,255	10,836
Accumulated other comprehensive income (loss)	-	(2)	-	-	-
Total members' equity	<u>11,412</u>	<u>15,021</u>	<u>13,789</u>	<u>12,604</u>	<u>12,129</u>
Total liabilities and members' equity	<u>\$ 150,763</u>	<u>\$ 140,792</u>	<u>\$ 127,123</u>	<u>\$ 108,380</u>	<u>\$ 81,757</u>
Year Ended December 31,					
<u>Statement of Income Data</u>					
Net interest income	\$ 3,925	\$ 4,026	\$ 3,456	\$ 2,969	\$ 2,960
(Provision for loan losses) or loan loss reversal	(4,968)	(344)	(98)	(182)	1,288
Provision for acquired property losses	(831)	-	-	-	-
Income from the Bank	536	516	417	298	160
Other noninterest income	518	412	408	273	337
Noninterest expense	(2,867)	(2,691)	(2,262)	(1,853)	(1,762)
Provision for income taxes	-	-	80	(86)	(457)
Net (loss) income	<u>\$ (3,687)</u>	<u>\$ 1,919</u>	<u>\$ 2,001</u>	<u>\$ 1,419</u>	<u>\$ 2,526</u>
<u>Key Financial Ratios for the Year</u>					
Return on average assets	-2.5%	1.4%	1.8%	1.6%	3.4%
Return on average members' equity	-22.9%	13.1%	14.8%	11.7%	23.0%
Net interest income as a percentage of average earning assets	2.8%	3.2%	3.2%	3.5%	4.2%
Net charge-offs (recoveries) as a percentage of average loans	0.1%	0.0%	0.0%	0.0%	0.0%

AGCREDIT OF SOUTH TEXAS, ACA

**FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA
(unaudited)
(dollars in thousands)**

	December 31,				
	2008	2007	2006	2005	2004
<u>Key Financial Ratios at Year End</u>					
Members' equity as a percentage of total assets	7.6%	10.7%	10.8%	11.6%	14.9%
Debt as a percentage of members' equity	1221.1%	838.2%	821.9%	759.9%	570.5%
Allowance for loan losses as a percentage of loans	3.4%	0.1%	0.2%	0.2%	0.1%
Permanent capital ratio	7.0%	11.5%	10.9%	11.1%	13.6%
Core surplus ratio	6.6%	11.1%	10.6%	10.5%	11.4%
Total surplus ratio	6.6%	11.1%	10.6%	10.7%	11.8%
<u>Net Income Distribution</u>					
Patronage refunds:					
Cash	\$ -	\$ 738	\$ 850	\$ -	\$ -
Allocated retained earnings	-	1,181	1,151	-	-

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of AgCredit of South Texas, ACA, including its wholly-owned subsidiaries, AgCredit of South Texas, PCA and AgCredit of South Texas, FLCA (Association) for the years ended December 31, 2008, 2007 and 2006, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the Association's Audit Committee.

Forward-Looking Information:

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will" or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international and farm-related business sectors;
- weather-related, disease and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

Significant Events:

Effective January 1, 2009, the Association signed a joint management agreement with Texas AgFinance, Farm Credit Services whereas the executive management team of Texas AgFinance, Farm Credit Services would manage the operations of the Association through the twelve months ending December 31, 2009. In April 2009, the joint management team reviewed the credit classifications and credit exposure of the Association's entire loan portfolio. It was determined that an additional bad debt provision of \$4,630,812 was needed to increase its allowance for loan losses related to the credit quality of its loan portfolio and potential loss exposure on adverse loans as of December 31, 2008. An additional provision of \$830,544 was recorded to establish an allowance for loss of the value of acquired property held by the Association on December 31, 2008. The findings of the internal review of the joint management team were confirmed by independent audits performed by the Bank.

The credit adjustment for December 31, 2008 financials recorded by the joint management team resulted in a violation of the net earnings and capital covenants of the General Financing Agreement (GFA) between the Association and the Bank. The Bank agreed to waive the Events of Default and refrain from exercising any other remedies it has under the GFA if the Association provides a satisfactory correction plan by June 1, 2009. Furthermore, the Bank has agreed to continue to waive such Events of Default so long as the Association in fact complies with the terms of such plan. The Association will comply with the terms of the waiver. Possible remedies to increase the financial position of the Association include reducing risk-weighted assets by selling loan volume, utilization of Farmer Mac credit default swaps, utilization of the Farmer Mac long-term standby commitment program, utilization of the Bank's long-term standby commitment program or merging with another District association.

In December 2008, the Association received a direct loan patronage of \$387,003 from the Bank, representing 30 basis points on the average daily balance of the Association's direct loan with the Bank. During 2008, the Association received \$76,379 in interest credit patronage payments from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$72,339 from the Bank, representing 65 basis points on the year's average daily balance of participations in capital markets loans with patronage commitments.

For over 75 years, the Association has continued to provide its members with quality financial services. The board of directors and management remain committed to maintaining the financial integrity of the Association while offering competitive loan products that meet the financial needs of agricultural producers.

Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable and prime-based interest rates. Loan maturities range from one to 40 years, with annual operating loans comprising the majority of the commercial loans

and 20- to 30-year maturities comprising the majority of the mortgage loans. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the Association's loan portfolio, including principal less funds held of \$146,148,872, \$134,324,772 and \$121,300,144 as of December 31, 2008, 2007 and 2006, respectively, is described more fully in detailed tables in Note 3 of the consolidated financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

Purchase and Sales of Loans:

During 2008, 2007 and 2006, the Association was participating in loans with lenders. As of December 31, 2008, 2007 and 2006, these participations totaled \$9,276,439, \$13,942,476 and \$16,384,243, or 6.3 percent, 10.4 percent and 13.5 percent of loans, respectively. There were no participations purchased from entities outside the District in 2008, 2007 and 2006. The Association has also sold participations of \$18,427,188, \$10,176,204 and \$17,752,375 as of December 31, 2008, 2007 and 2006, respectively.

Risk Exposure:

High-risk assets include nonaccrual loans, loans which are past due 90 days or more and still accruing interest, formally restructured loans and other property owned, net. The following table illustrates the Association's components and trends of high-risk assets serviced for the prior three years as of December 31:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 12,071,519	76.2%	\$ 2,754,427	59.7%	\$ 2,372,247	98.9%
90 days past due and still accruing interest	2,067,979	13.1%	1,856,456	40.3%	25,706	1.1%
Other property owned, net	1,692,636	10.7%	-	0.0%	-	0.0%
Total	\$ 15,832,134	100.0%	\$ 4,610,883	100.0%	\$ 2,397,953	100.0%

At December 31, 2008, 2007 and 2006, loans that were considered impaired were \$15,832,134, \$4,610,883 and \$2,397,953, representing 9.7 percent, 3.4 percent and 2.0 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. A detailed review of the loan portfolio by management, supported by an independent review performed by the Bank, noted a number of loans that required credit downgrades and additional allowance for loan loss provisions.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural real estate lender.

Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of or for the year ended, December 31:

	2008	2007	2006
Allowance for loan losses	\$ 5,005,961	\$ 147,844	\$ 270,000
Allowance for loan losses to total loans	3.4%	0.1%	0.2%
Allowance for loan losses to nonaccrual loans	89.7%	5.4%	11.4%
Allowance for loan losses to impaired loans	41.5%	3.2%	11.3%
Net charge-offs to average loans	0.1%	0.0%	0.0%

The allowance for loan losses is maintained based upon estimates that consider the general financial strength of the agricultural economy, loan portfolio composition, credit administration and the portfolio's prior loan loss experience. Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$5,005,961, \$147,844 and \$270,000 at December 31, 2008, 2007 and 2006, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates.

Results of Operations:

The Association's net loss for the year ended December 31, 2008, was \$3,687,028 as compared to net income of \$1,918,686 for the year ended December 31, 2007, reflecting a decrease of \$5,605,714, or 292.1 percent. The Association's net income for the year ended December 31, 2006 was \$2,000,870. Net income decreased \$82,184, or 4.1 percent, in 2007 versus 2006.

Net interest income for 2008, 2007 and 2006 was \$3,924,616, \$4,026,375 and \$3,456,450, reflecting a decrease of \$101,759, or 2.5 percent, for 2008 versus 2007, and an increase of \$569,925, or 16.5 percent, for 2007 versus 2006. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	2008		2007		2006	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Loans	\$ 138,855,654	\$ 9,051,804	\$ 127,596,455	\$ 10,670,422	\$ 108,110,101	\$ 8,807,334
Interest-bearing liabilities	129,027,331	5,127,188	118,863,523	6,644,047	99,105,138	5,350,884
Impact of capital	\$ 9,828,323		\$ 8,732,932		\$ 9,004,963	
Net interest income		\$ 3,924,616		\$ 4,026,375		\$ 3,456,450

	Average Yield	Average Yield	Average Yield
Yield on loans	6.52%	8.36%	8.15%
Cost of interest-bearing liabilities	3.97%	5.59%	5.40%
Interest rate spread	2.55%	2.77%	2.75%

	2008 vs. 2007			2007 vs. 2006		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income	\$ 941,405	\$ (2,560,023)	\$ (1,618,618)	\$ 1,587,475	\$ 275,613	\$ 1,863,088
Interest expense	595,144	(2,112,003)	(1,516,859)	1,042,840	250,323	1,293,163
Net interest income	\$ 346,261	\$ (448,020)	\$ (101,759)	\$ 544,636	\$ 25,289	\$ 569,925

Interest income decreased by \$1,618,618, or 15.2 percent, compared to 2007, primarily due to decreases in rates during the year. Interest expense for 2008 decreased by \$1,516,859, or 22.8 percent, compared to 2007 due to decrease in rates paid for funds. The interest rate spread decreased by 22 basis points to 2.55 percent in 2008 from 2.77 percent in 2007. The interest rate spread increased by 2 basis points to 2.77 percent in 2007 from 2.75 percent in 2006.

Noninterest income for 2008 increased by \$117,963, or 12.6 percent, compared to 2007, due primarily to an increase in patronage income from the Bank created by an increase in volume. Changes in loan fee schedules and fees earned on a large participation loan put together by the Association also contributed. Noninterest income for 2007 increased by \$110,820, or 13.4 percent, compared to 2006, due primarily to an increase in patronage income from the Bank created by an increase in volume.

Provisions for loan losses and losses related to acquired property owned by the Association increased \$5,454,789 in 2008. Independent appraisals and credit reviews resulted in the Association increasing its allowance for loan losses and reserves on acquired property to compensate for its potential loss exposure on loans and property held as assets. Based on updated internal and Bank credit reviews, 14.8 percent of total loans were considered substandard credit based on management's credit underwriting standards. Updated appraisals reported lesser collateral values on property and equipment used to securitize these loans, which resulted in the increase to the allowance accounts.

Noninterest expenses consist primarily of salaries, employee benefits and purchased services. Expenses for purchased services may include administrative services, marketing, information systems, accounting and loan processing, among others. Increased noninterest expenses of \$167,129 and \$436,888 in 2008 and 2007, respectively, are a result of the continued growth of the Association from 2006 through 2008 with the resulting increase in Insurance Fund expense, additional staff and aggressive marketing efforts that have produced an increase in volume.

For the year ended December 31, 2008, the Association's return on average assets was (2.5) percent, as compared to 1.4 percent and 1.8 percent for the years ended December 31, 2007 and 2006, respectively. For the year ended December 31, 2008, the Association's return on average members' equity was (22.9) percent, as compared to 13.1 percent and 14.8 percent for the years ended December 31, 2007 and 2006, respectively. As discussed in "Significant Events," the net loss for the year ended December 31, 2008, resulted in the Association violating its net earnings and capital covenants of the General Financing Agreement with the Bank.

Because the Association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank would have a similar effect on the operations of the Association.

Liquidity and Funding Sources:

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.

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$136,315,538, \$121,974,952 and \$110,300,172 as of December 31, 2008, 2007 and 2006, respectively, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 3.30 percent, 5.26 percent and 5.65 percent at December 31, 2008, 2007 and 2006, respectively. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a financing agreement. The increase in note payable to the Bank and related

accrued interest payable since December 31, 2007, is due to the increase in loan volume. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$9,397,551, \$11,935,196 and \$10,765,910 at December 31, 2008, 2007 and 2006, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$142,616,201 as defined by the general financing agreement.

The liquidity policy of the Association is to manage cash balances to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2009. As borrower payments are received, they are applied to the Association's note payable to the Bank.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the coming year. Management will continue to focus on increasing its liquidity to ensure it has adequate capital to support operations.

Capital Resources:

The Association's capital position decreased substantially with the allowance provisions recorded in 2008. The Association's members' equity totaled \$11,411,578, \$15,021,433 and \$13,788,929 at December 31, 2008, 2007 and 2006, respectively. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The Association's permanent capital ratio at December 31, 2008, 2007 and 2006 was 7.0 percent, 11.5 percent and 10.9 percent, respectively. Management believes that current allowances are sufficient to cover the inherent risk in its loan portfolio. This will help the Association build upon its current capital base with earnings from future operations.

The core surplus ratio measures available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The Association's core surplus ratio at December 31, 2008, 2007 and 2006 was 6.6 percent, 11.1 percent and 10.6 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 3.5 percent.

The total surplus ratio measures available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the reserves existing to protect borrowers' investment in the Association. The Association's total surplus ratio at December 31, 2008 was 6.6 percent, which was not in compliance with the FCA's minimum ratio requirement of 7.0 percent. The Association's total surplus ratio at December 31, 2007 and 2006 was 11.1 percent and 10.6 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent. Management is engaged in ongoing discussions with FCA as to plans for increasing the Association's capital to an acceptable level. FCA has asked management for a revised 2009 Business Plan and Capital Adequacy Plan detailing expected financial and operating results through the end of fiscal year 2011. Management anticipates the Association will be in compliance with all FCA regulatory ratios by the end of fiscal year 2009. If expected results fail to meet FCA minimums by this timeframe, FCA could enforce asset liquidation.

In 2008, 2007 and 2006, the Association paid patronage distributions of \$737,475, \$850,463 and \$0, respectively. See Note 7 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

Relationship With the Bank:

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 6 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank provides computer systems to support the critical operations of all District associations. In addition, each association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 10 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the Bank provides many services that the Association can utilize, such as administrative, marketing, information systems and accounting services. Additionally, the Bank allocates District expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums.

Summary:

Over the past 75 years, regardless of the state of the agricultural economy, your Association's board of directors and management, as well as the board of directors and management of the Bank, have been committed to offering their borrowers a ready source of financing at a competitive price. Your continued support will be critical to the success of this Association.

Report of Independent Auditors

To the Board of Directors and Stockholders of
AgCredit of South Texas, ACA:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity, and cash flows present fairly, in all material respects, the financial position of AgCredit of South Texas, ACA and subsidiaries (Association) at December 31, 2008, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Austin, Texas
May 28, 2009

AGCREDIT OF SOUTH TEXAS, ACA

CONSOLIDATED BALANCE SHEET

	December 31,		
	2008	2007	2006
<u>Assets</u>			
Cash	\$ 1,751,258	\$ 247,491	\$ 547,476
Loans	146,148,872	134,324,772	121,300,144
Less: allowance for loan losses	5,005,961	147,844	270,000
Net loans	141,142,911	134,176,928	121,030,144
Accrued interest receivable	2,592,184	3,010,057	2,791,429
Investment in and receivable from the Bank:			
Capital stock	2,557,130	2,353,295	1,952,910
Other	72,339	53,835	-
Deferred taxes, net	12,562	12,562	63,682
Other property owned, net	1,692,636	-	-
Premises and equipment	889,777	899,992	641,725
Other assets	52,123	38,079	96,065
Total assets	\$ 150,762,920	\$ 140,792,239	\$ 127,123,431
<u>Liabilities</u>			
Note payable to the Bank	\$ 136,315,538	\$ 121,974,952	\$ 110,300,172
Advance conditional payments	393,413	417,314	238,039
Accrued interest payable	387,778	527,783	520,161
Drafts outstanding	2,021,262	1,874,028	1,206,323
Patronage distributions payable	464	737,939	850,000
Other liabilities	232,887	238,790	219,807
Total liabilities	139,351,342	125,770,806	113,334,502
<u>Members' Equity</u>			
Capital stock and participation certificates	513,170	436,815	382,685
Allocated retained earnings	2,332,081	2,332,081	1,150,870
Unallocated retained earnings	8,566,327	12,254,447	12,255,374
Accumulated other comprehensive income (loss)	-	(1,910)	-
Total members' equity	11,411,578	15,021,433	13,788,929
Total liabilities and members' equity	\$ 150,762,920	\$ 140,792,239	\$ 127,123,431

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

AGCREDIT OF SOUTH TEXAS, ACA

CONSOLIDATED STATEMENT OF OPERATIONS

	Year Ended December 31,		
	2008	2007	2006
<u>Interest Income</u>			
Loans	\$ 9,051,804	\$ 10,670,422	\$ 8,807,334
<u>Interest Expense</u>			
Note payable to the Bank	5,123,328	6,640,403	5,347,240
Advance conditional payments	3,860	3,644	3,644
Total interest expense	<u>5,127,188</u>	<u>6,644,047</u>	<u>5,350,884</u>
Net interest income	<u>3,924,616</u>	<u>4,026,375</u>	<u>3,456,450</u>
<u>Provision for Losses</u>			
Provision for loan losses	4,968,170	343,925	98,180
Provision for acquired property losses	830,544	-	-
Net interest income after provision for loan losses	<u>(1,874,098)</u>	<u>3,682,450</u>	<u>3,358,270</u>
<u>Noninterest Income</u>			
Patronage income from the Bank	535,548	516,411	417,152
Loan fees	443,333	390,998	286,576
Financially related services income	53,466	13,067	100,828
Other noninterest income	21,274	15,182	20,282
Total noninterest income	<u>1,053,621</u>	<u>935,658</u>	<u>824,838</u>
<u>Noninterest Expenses</u>			
Salaries and employee benefits	1,411,512	1,356,487	1,074,921
Directors' expense	146,782	77,800	89,338
Purchased services	287,068	270,910	241,368
Travel	97,540	80,106	93,647
Occupancy and equipment	135,887	140,850	118,055
Communications	36,027	41,128	42,219
Advertising	199,270	183,042	189,490
Public and member relations	128,611	152,666	99,959
Supervisory and exam expense	51,250	50,117	44,210
Insurance Fund premiums	217,320	213,000	177,651
Loss on sale of premises and equipment, Net	-	8,861	-
Other noninterest expense	155,284	124,455	91,676
Total noninterest expenses	<u>2,866,551</u>	<u>2,699,422</u>	<u>2,262,534</u>
Income before income taxes	<u>(3,687,028)</u>	<u>1,918,686</u>	<u>1,920,574</u>
Benefit from income taxes	-	-	(80,296)
Net (loss) income	<u>\$ (3,687,028)</u>	<u>\$ 1,918,686</u>	<u>\$ 2,000,870</u>

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

AGCREDIT OF SOUTH TEXAS, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2005	\$ 348,925	\$ -	\$ 12,255,374	\$ -	\$ 12,604,299
Net income	-	-	2,000,870	-	2,000,870
Capital stock/participation certificates issued	75,625	-	-	-	75,625
Capital stock/participation certificates and allocated retained earnings retired	(41,865)	-	-	-	(41,865)
Patronage refunds:					
Cash	-	-	(850,000)	-	(850,000)
Capital stock/participation certificates and allocated retained earnings	-	1,150,870	(1,150,870)	-	-
Balance at December 31, 2006	382,685	1,150,870	12,255,374	-	13,788,929
Net income	-	-	1,918,686	-	1,918,686
Adjustment to initially apply SFAS No. 158	-	-	-	(1,910)	(1,910)
Capital stock/participation certificates issued	93,920	-	-	-	93,920
Capital stock/participation certificates and allocated retained earnings retired	(39,790)	-	-	-	(39,790)
Patronage refunds:					
Cash	-	-	(737,475)	-	(737,475)
Change in estimated patronage declared in 2006 paid in 2008	-	-	(927)	-	(927)
Capital stock/participation certificates and allocated retained earnings	-	1,181,211	(1,181,211)	-	-
Balance at December 31, 2007	436,815	2,332,081	12,254,447	(1,910)	15,021,433
Adjustment to beginning balance due to SFAS No. 158 accounting change	-	-	-	-	-
Balance at January 1, 2008	436,815	2,332,081	12,254,447	(1,910)	15,021,433
Comprehensive income					
Net loss	-	-	(3,687,028)	-	(3,687,028)
Change in pension and post retirement benefit plans	-	-	(34)	1,910	1,876
Total comprehensive income	-	-	(3,687,062)	1,910	(3,685,152)
Capital stock/participation certificates issued	104,870	-	-	-	104,870
Capital stock/participation certificates and allocated retained earnings retired	(28,515)	-	-	-	(28,515)
Patronage refunds:					
Cash	-	-	(1,058)	-	(1,058)
Capital stock/participation certificates and allocated retained earnings	-	-	-	-	-
Balance at December 31, 2008	\$ 513,170	\$ 2,332,081	\$ 8,566,327	\$ -	\$ 11,411,578

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

AGCREDIT OF SOUTH TEXAS, ACA

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net (loss) income	\$ (3,687,028)	\$ 1,918,686	\$ 2,000,870
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	4,968,170	343,925	98,180
Provision for acquired property	830,544	-	-
Depreciation	57,798	61,933	58,161
Loss on sale of premises and equipment, net	-	8,861	-
(Increase) decrease in accrued interest receivable	417,873	(218,698)	(826,404)
Decrease (increase) in deferred tax assets	-	51,120	(30,399)
Decrease (increase) in other assets	(14,044)	57,986	(25,256)
(Decrease) increase in accrued interest payable	(140,005)	7,622	165,293
(Decrease) increase in other liabilities	(5,085)	17,143	87,673
Net cash provided by operating activities	<u>2,428,223</u>	<u>2,248,578</u>	<u>1,528,118</u>
Cash flows from investing activities:			
Increase in loans, net	(14,475,837)	(14,000,218)	(17,211,033)
Cash recoveries of loans previously charged off	-	455,674	103,142
Proceeds from purchase of investment in the bank	(203,835)	(400,385)	(469,182)
Purchases of premises and equipment	(47,583)	(330,061)	(39,580)
Proceeds from sales of premises and equipment	-	1,000	8,226
Net cash used in investing activities	<u>(14,727,255)</u>	<u>(14,273,990)</u>	<u>(17,608,427)</u>

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

AGCREDIT OF SOUTH TEXAS, ACA

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from financing activities:			
Net draws on note payable to the Bank	14,340,586	11,674,780	16,165,308
Increase in drafts outstanding	147,234	667,705	395,246
(Decrease) increase in advance conditional payments	(23,901)	179,275	(104,761)
Issuance of capital stock and participation certificates	104,870	120,730	75,625
Retirement of capital stock and participation certificates	(28,515)	(66,600)	(41,865)
Patronage distributions paid	(737,475)	(850,463)	-
Net cash provided by financing activities	13,802,799	11,725,427	16,489,553
Net increase (decrease) in cash	1,503,767	(299,985)	409,244
Cash at the beginning of the year	247,491	547,476	138,232
Cash at the end of the year	\$ 1,751,258	\$ 247,491	\$ 547,476
Supplemental schedule of noncash investing and financing activities:			
Loans transferred to other property owned, net	1,692,636	-	-
Loans charged off	110,053	921,755	88,857
Patronage distributions declared	1,058	737,475	850,000
Elimination of SFAS No. 158	(1,910)	1,910	-
Supplemental cash information:			
Cash paid during the year for:			
Interest	\$ 5,267,193	\$ 6,632,781	\$ 5,185,591

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

AGCREDIT OF SOUTH TEXAS, ACA
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND OPERATIONS:

- A. Organization: AgCredit of South Texas, ACA, including its wholly-owned subsidiaries, AgCredit of South Texas, PCA and AgCredit of South Texas, FLCA (collectively called the Association), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Cameron, Willacy, Hidalgo, Starr, Jim Hogg, Zapata, Duval and Webb in the state of Texas.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). The most recent significant amendment to the Act was the Agricultural Credit Act of 1987 (1987 Act). At December 31, 2008, the System consisted of four Farm Credit Banks and their affiliated associations, one Agricultural Credit Bank and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related associations are collectively referred to as the District. The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District associations. At December 31, 2008, the District consisted of the Bank, six FLCAs and 13 ACA parent companies, which have two wholly-owned subsidiaries, an FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations, and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System bank has been required to pay premiums, which may be passed on to the associations, into the Insurance Fund, based on its annual average loan principal outstanding, until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each bank’s pro rata share of outstanding insured debt. The Farm Bill imposes premiums of 20 basis points on adjusted insured debt obligations, with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily-impaired investments.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services that can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The Association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The Association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance.

The Association’s financial condition may be affected by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect stockholders’ investment in the Association. Upon request, stockholders of the

Association will be provided with the Tenth Farm Credit District's Annual Report to Stockholders, which includes the combined financial statements of the Bank and all of the District associations. The District's annual report discusses the material aspects of the financial condition, changes in financial condition, and results of operations for the Bank and the District. In addition, the District's annual report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Fund.

The lending and financial services offered by the Bank are described in Note 1 of the District's annual report to stockholders.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of AgCredit of South Texas, PCA and AgCredit of South Texas, FLCA. All significant intercompany transactions have been eliminated in consolidation.

- A. Cash and Cash Equivalents: Cash and cash equivalents, as included in the statement of cash flows, represent cash on hand and on deposit at local banks.
- B. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans are carried at their principal amount outstanding adjusted for charge-offs.

Statement of Financial Accounting Standards (SFAS) No. 91, "Accounting for Nonrefundable Fees and Costs Associated With Originating and Acquiring Loans and Initial Direct Costs of Leases," requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield. SFAS No. 91 has not been implemented because the effects were not material to the financial position or results of operations for any year presented.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest and penalty interest incurred as a result of past-due status, is collected or otherwise discharged in full.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified as "doubtful" or "loss." If previously unrecognized interest income exists upon transfer of a nonaccrual loan to accrual status, interest income will be recognized as cash payments are received.

Loans are charged off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable 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. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

- C. **Capital Stock Investment in the Bank:** The Association's investment in the Bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the Association's proportional utilization of the Bank compared to other District associations. The Bank requires a minimum stock investment of 2 percent of the Association's average borrowing from the Bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Bank may increase the percentage of stock held by an association from 2 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5 percent of the average outstanding balance of borrowings from the Bank.

- D. **Other Property Owned, Net:** Other property owned, net, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned, net.
- E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- F. **Advance Conditional Payments:** The Association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the Association on such accounts at rates established by the board of directors.
- G. **Employee Benefit Plans:** Employees of the Association participate in either the defined benefit retirement plan (DB Plan) or the defined contribution plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. The DB Plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB Plan is noncontributory and provides benefits based on salary and years of service. The "Projected Unit Credit" actuarial method is used for financial reporting and funding purposes for the DB Plan.

Participants in the DC Plan generally include employees who elected to transfer from the DB Plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC Plan direct the placement of their employers' contributions, 5.0 percent of salaries for the year ended December 31, 2008, made on their behalf into various investment alternatives.

The structure of the District's DB plan is characterized as multi-employer, since neither the assets, liabilities nor costs of any plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The Association recognized pension costs for the DC Plan of \$40,880, \$36,570 and \$23,035 for the years ended December 31, 2008, 2007 and 2006, respectively. For the DB Plan, the Association recognized pension costs of \$129,829, \$74,275 and \$87,479 for the years ended December 31, 2008, 2007 and 2006, respectively.

The Association also participates in the Farm Credit Benefits Alliance 401(k) Plan which requires the associations to match 100 percent of employee contributions up to 3.0 percent of base salary and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of base salary. Association 401(k) plan costs are expensed as incurred. The Association's contributions to the 401(k) plan were \$38,018, \$37,131 and \$25,007 for the years ended December 31, 2008, 2007 and 2006, respectively.

In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities.

- H. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. Deferred taxes are provided on the Association's taxable income on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. Deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

Deferred income taxes have not been provided by the Association on patronage stock distributions from the Bank prior to January 1, 1993, the adoption date of SFAS No. 109. Management's intent is (1) to permanently invest these and other undistributed earnings in the Bank, thereby indefinitely postponing their conversion to cash, or (2) to pass through any distribution related to pre-1993 earnings to Association borrowers through qualified patronage allocations.

The Association has not provided deferred income taxes on amounts allocated to the Association which relate to the Bank's post-1992 earnings to the extent that such earnings will be passed through to Association borrowers through qualified patronage allocations. Additionally, deferred income taxes have not been provided on the Bank's post-1992 unallocated earnings. The Bank currently has no plans to distribute unallocated Bank earnings and does not contemplate circumstances that, if distributions were made, would result in taxes being paid at the Association level.

- I. **Patronage Refunds From the Farm Credit Bank of Texas:** The Association records patronage refunds from the Bank upon receipt of the patronage.
- J. **Fair Value Measurement:** Effective January 1, 2008, the System adopted SFAS No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

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

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

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or

estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, and highly structured or long-term derivative contracts.

The fair value disclosures have been expanded in accordance with SFAS No. 157, as disclosed in Note 12.

K. Recently Issued Accounting Pronouncements: In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under this Statement and related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Association does not expect adoption of SFAS No. 161 to have any impact on its financial statement disclosures.

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans as of December 31 follows:

Loan Type	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Real estate mortgage	\$ 79,657,954	54.5%	\$ 77,729,011	57.9%	\$ 64,990,782	53.6%
Production and intermediate term	51,862,951	35.5%	42,968,670	32.0%	40,343,623	33.2%
Agribusiness:						
Loans to cooperatives	1,487,570	1.0%	1,813,816	1.4%	2,431,700	2.0%
Processing and marketing	8,658,600	5.9%	7,967,119	5.9%	6,668,289	5.5%
Farm-related business	107,264	0.1%	1,007,185	0.7%	2,124,398	1.8%
Communication	-	0.0%	-	0.0%	1,443,363	1.2%
Energy	709,083	0.5%	794,878	0.6%	847,210	0.7%
Rural residential real estate	3,665,450	2.5%	2,054,093	1.5%	2,450,779	2.0%
Total	\$ 146,148,872	100.0%	\$ 134,334,772	100.0%	\$ 121,300,144	100.0%

Geographic Distribution:

County	2008	2007	2006
Hidalgo	41.5%	39.9%	35.8%
Cameron	18.7%	21.4%	21.5%
Willacy	15.7%	16.4%	18.7%
Starr	4.6%	3.6%	4.5%
Duval	2.3%	2.4%	2.0%
Jim Hogg	2.1%	2.1%	2.3%
Dallas	1.3%	1.3%	0.0%
Randall	1.2%	1.4%	1.6%
Webb	1.1%	1.4%	1.3%
Other States	5.3%	5.3%	8.0%
Other	6.2%	4.8%	4.3%
Totals	100.0%	100.0%	100.0%

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Operation/Commodity	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Field crops except cash grains	\$ 36,388,275	24.9%	\$ 38,583,047	28.7%	32,170,229	26.5%
General farms, primarily crops	19,316,448	13.2%	16,790,368	12.5%	17,259,539	14.2%
Hunting, trapping and game propagation	18,265,816	12.5%	15,499,372	11.5%	3,577,610	3.0%
Livestock, except dairy and poultry	16,177,431	11.1%	16,471,839	12.3%	11,443,107	9.4%
Real estate	14,726,824	10.1%	14,177,405	10.6%	2,000,000	1.7%
Cash grains	11,235,995	7.7%	3,660,171	2.7%	1,506,542	1.2%
Rural home loans	6,629,825	4.5%	4,840,382	3.6%	384,517	0.3%
Fruit and tree nuts	5,832,223	4.0%	5,512,975	4.1%	1,982,795	1.6%
Vegetables and melons	3,724,130	2.5%	4,388,714	3.3%	1,736,972	1.4%
Animal specialties	2,551,846	1.7%	4,427,644	3.3%	4,357,749	3.6%
Electric services	2,209,083	1.5%	2,294,878	1.7%	847,210	0.7%
Dairy farms	2,136,571	1.5%	2,209,948	1.6%	3,020,037	2.5%
Food and kindred products	2,015,205	1.4%	1,991,974	1.5%	2,065,248	1.7%
Agricultural services	1,539,692	1.1%	1,609,998	1.2%	1,883,534	1.6%
Paper and allied products	950,000	0.6%	-	0.0%	-	0.0%
Other	2,449,508	1.7%	1,866,057	1.4%	37,065,055	30.6%
Total	\$ 146,148,872	100.0%	\$ 134,324,772	100.0%	\$ 121,300,144	100.0%

The Association revised the method it used to report commodity codes in fiscal year 2007. This resulted in fewer commodities classified as “Other” and reports a better picture of the diversification in the Association’s loan portfolio.

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 97 percent if guaranteed by a government agency) of the property’s appraised value. However, a decline in a property’s market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan-to-value ratios in excess of the regulatory maximum.

The Association has obtained loan guarantees in the form of standby commitments to purchase qualifying loans from the Federal Agricultural Mortgage Corporation through an arrangement with the Bank. At December 31, 2008, 2007 and 2006, loans totaling \$20,347,015, \$20,779,194 and \$15,124,001, respectively, were guaranteed by these commitments. Fees paid for these guarantees totaled \$88,598, \$75,551 and \$17,087 in 2008, 2007 and 2006, respectively, and are reflected in “other noninterest expense.”

Asset Quality:

The following table reflects the credit quality of the Association’s loan volume as of December 31:

	2008	2007	2006
Acceptable	76.6%	91.5%	88.2%
Special mention	8.6%	2.2%	4.6%
Substandard	14.8%	6.3%	7.2%
Doubtful	0.0%	0.0%	0.0%
Loss	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%

The application of more universal credit underwriting standards by the joint management team resulted in material adjustments to the Association’s credit quality valuation of its loan portfolio.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms. The following presents information relating to impaired loans as of December 31:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Nonaccrual loans						
Current as to principal and interest	\$ 5,981,074	42.3%	\$ -	0.0%	\$ 96,556	4.0%
Past due	6,090,445	43.1%	2,754,427	59.7%	2,275,691	94.9%
Total nonaccrual loans	<u>12,071,519</u>	<u>85.4%</u>	<u>2,754,427</u>	<u>59.7%</u>	<u>2,372,247</u>	<u>98.9%</u>
Accrual loans						
90 days or more past due	2,067,979	14.6%	1,856,456	40.3%	25,706	1.1%
Formally restructured	-	0.0%	-	0.0%	-	0.0%
Total impaired accrual loans	<u>2,067,979</u>	<u>14.6%</u>	<u>1,856,456</u>	<u>40.3%</u>	<u>25,706</u>	<u>1.1%</u>
Total impaired loans	<u>\$ 14,139,498</u>	<u>100.0%</u>	<u>\$ 4,610,883</u>	<u>100.0%</u>	<u>\$ 2,397,953</u>	<u>100.0%</u>

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2008.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2, "Summary of Significant Accounting Policies." The following table presents interest income recognized on impaired loans.

	2008	2007	2006
Interest income recognized on nonaccrual loans	\$ 328,553	\$ 174,677	\$ 196,744
Interest income recognized on impaired accrual loans	172,120	220,427	(1,047)
Interest income recognized on impaired loans	<u>\$ 500,673</u>	<u>\$ 395,104</u>	<u>\$ 195,697</u>

A summary of the allowance for loan losses as of December 31 follows:

	2008	2007	2006
Beginning balance	\$ 147,844	\$ 270,000	\$ 157,535
Provision for loan losses	4,968,170	343,925	98,180
Loans charged off	(110,053)	(921,755)	(88,857)
Recoveries	-	455,674	103,142
Allowance for loan losses	<u>\$ 5,005,961</u>	<u>\$ 147,844</u>	<u>\$ 270,000</u>

The following table presents information concerning impaired loans as of December 31:

	2008	2007	2006
Impaired loans with related allowance	\$ 11,531,447	\$ 29,827	\$ 25,539
Impaired loans with no related allowance	2,608,051	4,581,056	2,372,414
Total impaired loans	<u>\$ 14,139,498</u>	<u>\$ 4,610,883</u>	<u>\$ 2,397,953</u>
Allowance on impaired loans	<u>\$ 4,477,046</u>	<u>\$ 27,791</u>	<u>\$ 25,539</u>

The following table summarizes impaired loan information for the years ended December 31:

	2008	2007	2006
Average impaired loans	<u>\$ 4,390,278</u>	<u>\$ 4,260,733</u>	<u>\$ 455,607</u>

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest income which would have been recognized under the original terms	\$ 674,365	\$ 815,638	\$ 307,085
Less: interest income recognized	(500,673)	(395,104)	(195,697)
Foregone interest income	<u>\$ 173,692</u>	<u>\$ 420,534</u>	<u>\$ 111,388</u>

NOTE 4 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Land and improvements	\$ 99,675	\$ 99,675	\$ 99,675
Building and improvements	775,489	743,318	530,342
Furniture and equipment	199,079	192,627	145,961
Computer equipment and software	112,960	104,000	123,105
Automobiles	144,348	144,348	144,348
	<u>1,331,551</u>	<u>1,283,968</u>	<u>1,043,431</u>
Accumulated depreciation	(441,774)	(383,976)	(401,706)
Total	<u>\$ 889,777</u>	<u>\$ 899,992</u>	<u>\$ 641,725</u>

The Association leases office space in Hebronville on a month-to-month basis for \$685 per month.

NOTE 5 – OTHER PROPERTY OWNED, NET:

Net gain (loss) on other property owned, net consists of the following for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating income (expense), net	<u>\$ (3,600)</u>	<u>\$ -</u>	<u>\$ -</u>

NOTE 6 — NOTE PAYABLE TO THE BANK:

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. The Association's indebtedness to the Bank represents borrowings by the Association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the Association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the Bank's cost of funding the loans the Association has outstanding to its borrowers.

The total amount and the weighted average interest rate of the Association's direct loan from the Bank at December 31, 2008, 2007 and 2006, were \$136,315,538 at 3.30 percent, \$121,974,952 at 5.26 percent and \$110,300,172 at 5.65 percent, respectively.

Under the Act, the Association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2008, 2007 and 2006, the Association's note payable was within the specified limitations. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$142,616,201, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information and establishing policies and procedures. Remedies specified in the financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of December 31, 2008 the Association was not in compliance with the credit quality and earnings covenants in its financing agreement with the Bank. Management is currently engaged with the Bank to remedy the noncompliance of these covenants. The Association sent a written

response to the Bank outlining its plan to restore the Association to compliance of all covenants. The Bank has agreed to temporarily extend the Association's financing agreement pending approval and acceptance of the revised 2009 Business Plan and Capital Adequacy Plan. As of December 31, 2007 and 2006, the Association was not subject to remedies associated with the covenants in the financing agreement.

NOTE 7 — MEMBERS' EQUITY:

In accordance with the Act and Association's capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. The investment in Class B capital stock (for agricultural loans) or participation certificates (for rural home and farm-related business loans) is equal to 2 percent of the loan amount up to a maximum amount of \$1,000. The maximum stock required was reduced to \$1,000 per borrower as of June 1, 2005. The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the Association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Association may increase the percentage of stock requirement for each borrower up to a maximum of 10 percent of the loan amount.

Each owner of Class B capital stock is entitled to a single vote, while participation certificates provide no voting rights to their owners.

Within two years of repayment of a loan, the Association capital bylaws require the conversion of any borrower's outstanding Class B to Class A stock. Class A stock has no voting rights except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of Class B shares is made solely at the discretion of the Association's board of directors. At December 31, 2008, 2007 and 2006, the Association had \$471,905, \$404,070 and \$350,685, respectively, of Class B stock.

All borrower stock is at risk. As such, losses that result in impairment of capital stock or participation certificates shall be borne on a pro rata basis by all classes of common stock and participation certificates. In the event of liquidation of the Association, capital stock and participation certificates would be utilized as necessary to satisfy any remaining obligations in excess of the amounts realized on the sale or liquidation of assets. Any excess of the amounts realized on the sale or liquidation of assets over the Association's obligations to external parties and to the Bank would be distributed to the Association's stockholders.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the Association, as the board of directors may determine by resolution subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The Association did not pay dividends or patronage dividends prior to 2006. In December 2006 the board declared a cash patronage in the amount of \$850,000 to be paid in April 2007, and in December 2007 the board declared a cash patronage in the amount of \$737,475 to be paid in April 2008. The board did not declare a cash patronage in December 2008 to be paid in April 2009.

The FCA's capital adequacy regulations require the Association to achieve permanent capital and total surplus of at least 7.0 percent and core surplus of at least 3.5 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the ratio requirements can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association could be prohibited from reducing permanent capital by retiring stock or making certain other distributions to stockholders unless prescribed capital standards are met. The Association's permanent capital ratio, core surplus ratio and total surplus ratio at December 31, 2008, were 7.0 percent, 6.6 percent and 6.6 percent, respectively. No mandatory or additional discretionary actions have been assessed by FCA as of the writing of this annual report. Management intends to provide a revised 2009 Business Plan and Capital Adequacy Plan to FCA detailing its plan to bring the Association's surplus ratio back above the minimum requirement. Possible remedies to increase the financial position of the Association include reducing risk-weighted assets by selling loan volume, utilization of Farmer Mac credit default swaps, utilization of the Farmer Mac long-term standby commitment program, utilization of the Bank's long-term standby commitment program or merging with another District association.

The Association's Capital Adequacy Plan calls for monitoring the capital ratios discussed above on an ongoing basis. The Association has not yet established goals for its permanent capital ratio, core surplus ratio and total surplus ratio. The Association can use any of the programs referenced in the above paragraph to ensure all ratios meet or exceed FCA minimums.

An FCA regulation empowers FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

At December 31, the Association had the following shares of Class A capital stock, Class B stock and participation certificates outstanding at a par value of \$5 per share:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Class A stock	3,593	2,807	2,548
Class B stock	94,381	80,814	70,137
Participation certificates	4,660	3,742	3,852
Total	<u>102,634</u>	<u>87,363</u>	<u>76,537</u>

NOTE 8 — INCOME TAXES:

The provision for (benefit from) income taxes follows for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current:			
Federal	\$ -	\$ (34,734)	\$ (49,897)
Total current	<u>-</u>	<u>(34,734)</u>	<u>(49,897)</u>
Deferred:			
Federal	-	34,734	(30,399)
Total deferred	<u>-</u>	<u>34,734</u>	<u>(30,399)</u>
Total provision for (benefit from) income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (80,296)</u>

The Association had a total net operating loss carryforward of \$697,583 from its 2007 federal corporate tax return. The Association estimates it will use \$675,804 of the loss carryforward to offset 2008 taxable income. This will leave a net operating loss carryforward of \$21,779 that the Association plans to use to partially offset 2009 taxable earnings.

The provision for (benefit from) income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal (benefit) tax at statutory rate	\$ (1,253,590)	\$ 652,353	\$ 652,995
Effect of nontaxable FLCA subsidiary	1,398,455	(490,624)	(490,624)
Patronage distributions	-	(250,442)	(289,000)
Change in valuation allowance	-	85,626	-
Other	(144,865)	3,087	46,333
Provision for (benefit from) income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (80,296)</u>

Deferred tax assets and liabilities in accordance with SFAS No. 109, "Accounting for Income Taxes," are comprised of the following at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Deferred Tax Assets			
Allowance for loan losses	\$ 115,708	\$ 34,734	\$ 63,682
Loss carryforwards	7,405	-	-
Gross deferred tax assets	<u>123,113</u>	<u>34,734</u>	<u>63,682</u>
Deferred tax asset valuation allowance	<u>(110,551)</u>	<u>(22,172)</u>	<u>-</u>
Net deferred tax asset	<u>\$ 12,562</u>	<u>\$ 12,562</u>	<u>\$ 63,682</u>

The calculation of tax assets and liabilities involves various management estimates and assumptions as to the future taxable earnings including the following at December 31, 2008: Nonpatronage income is expected to be 10 percent of total taxable income (before

patronage), and patronage income retained is expected to be 100 percent of total patronage income on a tax basis. The expected future tax rates are based upon enacted tax laws.

The ACA is required to maintain an investment in the Bank of 2 percent of the average direct note. This investment can be held by both the PCA and FLCA. A deferred tax liability is established for the PCA for any excess investment in the Bank over that allocated to the 2 percent investment requirement. Upon formation of the ACA, additional amounts of previously excess investment held by the PCA were included in the calculation of the 2 percent requirement of the ACA. As a result of the decrease in the excess investment held by the PCA, the related deferred tax liability decreased \$9,603 in 2006.

The Association recorded valuation allowances of \$88,379 and \$22,172 during 2008 and 2007, respectively. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly. The Association has no uncertain tax provisions requiring disclosure under FIN 48.

NOTE 9 — EMPLOYEE BENEFIT PLANS:

Employee Retirement Plans: Employees of the Association participate in either the defined benefit retirement plan (DB Plan) or the defined contributions plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section G of Note 2, “Summary of Significant Accounting Policies.”

Other Postretirement Benefits: In addition to pension benefits, the Association does not provide certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). Retired employees pay for any benefits for which they are eligible if they wish to participate without participation by the Association.

In September 2006, the FASB issued SFAS No. 158, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007. SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, the System used a September 30 measurement date for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year-end measurement date. The System has applied the second approach, which allows for the use of the measurements determined for the prior year end.

Under this alternative, pension and postretirement benefit income measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 2007 measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As a result, the Association decreased retained earnings \$1,910, and increased the pension and other postretirement benefit liabilities by \$1,910.

The following table reflects the benefit obligation, cost and actuarial assumptions for the Association’s other postretirement benefits:

**10th Farm Credit District
Retiree Welfare Benefit Plans**

Disclosure Information Under FASB Statement 132

	2008	2007	2006
Change in Accumulated Postretirement Benefit Obligation			
Accumulated postretirement benefit obligation, beginning of year	\$ 182	\$ 495	\$ 6,280
Service cost	-	3	389
Interest cost	15	30	330
Plan participants' contributions	435	6,813	-
Plan amendments	-	-	10,821
Special termination benefits	-	-	(5,583)
Actuarial loss (gain)	(197)	(346)	(846)
Benefits paid	(435)	(6,813)	(10,896)
Accumulated postretirement benefit obligation, end of year	\$ -	\$ 182	\$ 495
Change in Plan Assets			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Actual return on plan assets	-	-	-
Company contributions	-	-	75
Plan participants' contributions	435	6,813	10,821
Benefits paid	(435)	(6,813)	(10,896)
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ -	\$ (182)	\$ (495)
Amounts Recognized in Statement of Financial Position			
Noncurrent assets	\$ -	\$ -	\$ (5,583)
Current liabilities	-	-	7,751
Noncurrent liabilities	-	-	-
Total	\$ -	\$ (182)	\$ 1,673
Amounts Recognized in Accumulated Other Comprehensive Income			
Net actuarial loss (gain)	-	6,820	N/A
Prior service cost (credit)	-	(4,910)	N/A
Net transition obligation (asset)	-	-	N/A
Total	-	1,910	N/A
Additional Information			
Increase in minimum liability included in other comprehensive income	\$ (1,910)	\$ -	\$ -

Weighted-Average Assumptions Used to Determine Obligations at Year-end

	12/31/2008	9/30/2007	9/30/2006
Measurement date	12/31/2008	9/30/2007	9/30/2006
Discount rate	6.30%	6.50%	6.00%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	8.5%/6.5%	8.5%/6.5%	9.0%/6.75%
Health care cost trend rate assumed for next year - Rx	12.00%	12.00%	13.00%
Ultimate health care cost trend rate	5.00%	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2015	2016	2016

Total Cost	2008	2007	2006
Service cost	\$ -	\$ 3	\$ 389
Interest cost	12	30	330
Expected return on plan assets	-	-	-
Amortization of:			
Unrecognized net transition obligation	-	-	-
Unrecognized prior service cost	(673)	(673)	-
Unrecognized net loss (gain)	525	585	516
Net postretirement benefit cost	(136)	(55)	1,235
Adjustment to retained earnings for 2008 due to change in measurement date	\$ (34)	\$ -	\$ -
FAS88 Accounting for settlements/curtailments/special termination benefits	\$ 1,898	\$ -	\$ -
Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income			
Net actuarial loss (gain)	\$ (197)	\$ -	\$ -
Amortization of net actuarial loss (gain)	(656)	-	-
FAS88 recognition of loss (gain)	(5,967)	-	-
Prior service cost (credit)	-	-	-
Amortization of prior service cost	841	-	-
FAS88 recognition of prior service cost	4,069	-	-
Amortization of transition liability (asset)	-	-	-
Total recognized in other comprehensive income	\$ (1,910)	\$ -	\$ -
AOCI Amounts Expected to be Amortized into Expense in 2009			
Unrecognized net transition obligation (asset)	\$ -	\$ -	\$ -
Unrecognized prior service cost	-	(673)	-
Unrecognized net loss (gain)	-	525	-
Total	\$ -	\$ (148)	\$ -
Weighted-Average Assumptions Used to Determine Benefit Cost			
Measurement date	9/30/2007	9/30/2006	9/30/2005
Discount rate	6.50%	6.50%	6.00%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	9.0%/6.75%	8.5%/6.5%	9.0%/6.75%
Health care cost trend rate assumed for next year - Rx	13.00%	12.00%	13.00%
Ultimate health care cost trend rate	4.75%	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2016	2016	2016
Expected Future Cash Flows			
Expected Benefit Payments (net of employee contributions)			
Fiscal 2009	\$ -	\$ -	\$ -
Fiscal 2010	-	-	-
Fiscal 2011	-	-	-
Fiscal 2012	-	-	-
Fiscal 2013	-	-	-
Fiscal 2014–2018	-	-	-
Expected Contributions			
Fiscal 2009	\$ -	\$ -	\$ -

NOTE 10 — RELATED PARTY TRANSACTIONS:

Directors of the Association, except for any director-elected directors, are required to be borrowers/stockholders of the Association. Also, in the ordinary course of business, the Association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons for the Association amounted to \$7,999,359, \$4,188,760 and \$4,729,229 at December 31, 2008, 2007 and 2006, respectively. During 2008, \$7,405,675 of new loans were made, and repayments totaled \$6,130,058. In the opinion of management, no such loans outstanding at December 31, 2008, 2007 and 2006 involved more than a normal risk of collectibility.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems, accounting services and allocations of expenses incurred by the Bank passed through to the associations such as FCSIC expenses. The Bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$196,187, \$190,721 and \$164,852 in 2008, 2007 and 2006, respectively.

The Association received patronage payments from the Bank totaling \$535,548, \$516,411 and \$417,152 during 2008, 2007 and 2006, respectively.

NOTE 11 — COMMITMENTS AND CONTINGENCIES:

In addition to those commitments and contingencies discussed in Note 2, "Summary of Significant Accounting Policies," the Association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2008, \$22,070,344 of commitments were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the balance sheet until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers, and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financing obligations. The fair value of these obligations at December 31, 2008 is based on fees for the unexpired period remaining, which is negligible. At December 31, 2008, \$3,670,550 of standby letters of credit were outstanding. Outstanding standby letters of credit have expiration dates ranging from February 1, 2009 to March 1, 2032. The maximum potential amount of future payments the Association is required to make under the guarantees is \$3,670,550.

NOTE 12 — DISCLOSURE ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS:

The following table presents the carrying amounts and estimated fair values of the Association's financial instruments at December 31, 2008, 2007 and 2006. Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, discount rates, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments as of December 31 follow:

	2008		2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets						
Cash	\$ 1,751,258	\$ 1,751,258	\$ 247,491	\$ 247,491	\$ 547,476	\$ 547,476
Loans, net	141,142,911	145,897,553	134,176,928	135,964,917	121,030,144	121,390,993
Financial liabilities						
Note payable to the Bank	136,315,538	140,907,562	121,974,952	123,600,776	110,300,172	110,629,029

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

A. Cash:

The carrying value is a reasonable estimate of fair value.

B. Loans:

Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association'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 Association'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 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. Where the net realizable value of the collateral exceeds the legal obligation for a particular loan, the legal obligation is generally used in place of net realizable value.

The carrying value of accrued interest approximates its fair value.

C. Investment in the Bank:

Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 2, "Summary of Significant Accounting Policies," the investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying consolidated balance sheet. The Association owns 1.1 percent of the equity of the Bank as of December 31, 2008. As of that date, the Bank's assets totaled \$14.8 billion and members' equity totaled \$744.5 million. The Bank's earnings were \$76.7 million during 2008.

D. Note Payable to the Bank:

The note payable to the Bank is not regularly traded; thus, quoted market prices are not available. Fair value of this instrument is discounted based on the Association's and Bank's loan rates as well as on management estimates. For the purposes of this estimate it is assumed that the cash flow on the note is equal to the principal payments on the Association's loan receivables plus accrued interest on the note payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures. Management has no basis to determine whether the fair values would be indicative of the value negotiated in an actual sale.

E. Commitments to extend credit:

The Association does not normally assess fees on its commitments to extend credit; hence, there is no fair value to be assigned to these commitments until they are funded.

NOTE 13 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED):

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,029	\$ 1,068	\$ 894	\$ 934	\$ 3,925
(Provision for) reversal of loan losses	(20)	(9)	(147)	(4,792)	(4,968)
Noninterest expense, net	(503)	(585)	(474)	(1,082)	(2,644)
Net income	\$ 506	\$ 474	\$ 273	\$ (4,940)	\$ (3,687)

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,074	\$ 1,017	\$ 994	\$ 941	\$ 4,026
(Provision for) reversal of loan losses	-	(439)	9	86	(344)
Noninterest expense, net	(509)	(556)	(454)	(244)	(1,763)
Net income	\$ 565	\$ 22	\$ 549	\$ 783	\$ 1,919

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 868	\$ 877	\$ 907	\$ 804	\$ 3,456
(Provision for) reversal of loan losses	-	-	-	(98)	(98)
Noninterest expense, net	(428)	(464)	(450)	(15)	(1,357)
Net income	\$ 440	\$ 413	\$ 457	\$ 691	\$ 2,001

NOTE 14 — SUBSEQUENT EVENTS:

The Board of Directors of AgCredit of South Texas, ACA and Texas AgFinance, FCS approved entering into a joint management agreement effective on January 1, 2009, wherein Texas AgFinance will provide management services for AgCredit of South Texas. With this agreement, Jimmy Wright will serve as the Chief Executive Officer; Mark Miller will serve as the Association's Chief Credit Officer; and Keith Ibrom will serve as Chief Financial Officer of AgCredit of South Texas effective January 1, 2009. The joint management team focused its efforts on reviewing the Association's loan portfolio. As a result of numerous credit reclassifications and revised collateral valuations, impaired loans increased from \$8,206,062 to \$14,139,498, and the provision for loan loss and write-down valuation of acquired property increased \$5,461,356.

DISCLOSURE INFORMATION AND INDEX

Disclosures Required by Farm Credit Administration Regulations

DESCRIPTION OF BUSINESS

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings or interest rates to borrowers and acquisitions or dispositions of material assets, if any, required to be disclosed in this section are incorporated herein by reference from "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

DESCRIPTION OF PROPERTY

The AgCredit of South Texas, ACA (Association) serves its eight-county territory through its main administrative and lending office at 555 International Blvd., Weslaco, Texas, 78596. Additionally, there are two branch lending offices located throughout the territory. The Association owns the office buildings in Weslaco and Raymondville, free of debt. The Association leases the office building in Hebbronville, Texas.

LEGAL PROCEEDINGS

In the ordinary course of business, the Association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the Association.

DESCRIPTION OF CAPITAL STRUCTURE

The information required to be disclosed in this section is incorporated herein by reference from Note 7 to the consolidated financial statements, "Members' Equity," included in this annual report.

DESCRIPTION OF LIABILITIES

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 11 to the consolidated financial statements, "Summary of Significant Accounting Policies" and "Commitments and Contingencies," respectively, included in this annual report.

RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS

The Association's financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (Bank), as discussed in Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report. The financial condition and results of operations of the Bank may materially affect the stockholders' investment in the Association.

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 78720-2590 or calling (512) 483-9204. Copies of the District's annual and quarterly stockholder reports can also be requested by e-mailing fcf@farmcreditbank.com. The District's annual and quarterly stockholder reports are also available on its web site at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to AgCredit of South Texas, ACA, 555 South International Blvd., Weslaco, Texas, 78596 or calling 956-447-5500. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing keith.ibrom@farmcreditbank.com. The Association's annual stockholder report is available on its web site at www.agcreditosouthtexas.com 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2008, required to be disclosed, is incorporated herein by reference to the “Five-Year Summary of Selected Combined Financial Data” included in this annual report to stockholders.

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

“Management’s Discussion and Analysis,” which precedes the combined financial statements in this annual report, is incorporated herein by reference.

DIRECTORS AND SENIOR OFFICERS

The Association’s member-elected and director-elected board of directors and senior officers are as follows:

<u>NAME</u>	<u>POSITION</u>	<u>DATE ELECTED/ EMPLOYED</u>	<u>TERM EXPIRES</u>
Bob Ed Stewart	Chairman	1990	2010
William (Bill) Barfield	Vice-Chairman	1993	2011
Jack Harbison, Jr.	Director	1992	2010
Billie Mack Simpson	Director	2006	2009
Randy Rolando	Outside Director	2008	2010
Francis L. Phillipp	Outside Director	2008	2011
Reagan Florence	Chief Executive Officer/President	2008	---
Wilbron Stanteen	Chief Financial Officer	2007	---

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

Bob Ed Stewart has been a member for over 34 years. He was a PCA loan officer at the Raymondville branch office for 15 years. Mr. Stewart formerly served on the board of directors for the Willacy County FSA Committee. He currently serves on the Farm Credit Bank of Texas Stockholders’ Committee. Mr. Stewart farms cotton, corn, milo, citrus and sugarcane in Hidalgo and Willacy counties. He has been on the board since 1990.

William (Bill) Barfield has been a member for over 25 years. He is chairman of the board for the Monte Mucho Soil and Water Conservation District. Mr. Barfield operates a cow/calf operation in Jim Hogg, Duval and Webb counties. He has been a member of the board since 1993. Mr. Barfield serves as chairman of the Compensation Committee.

Jack Harbison, Jr. has been a member for over 45 years. Mr. Harbison is a director of Hidalgo and Cameron County Irrigation District No. 9. He is a former member of the Hidalgo County Farm Service Agency Committee, board member of the Rio Grande Valley Sugar Growers, Inc. and board member of Rio Farms, Inc. Mr. Harbison farms cotton, milo, seed corn, vegetables and sugarcane in Hidalgo County. He has been a member of the board since 1992.

Billie Mack Simpson has been a member for 34 years. He currently farms cotton, grain and sugarcane in Cameron County and has ranching and hunting interests in Duval County. Mr. Simpson serves as president of the board of directors of South Texas Auction Company, Inc. in Alice, Texas, and is a board member of the Rio Grande Valley Sugar Growers, Inc. He has been a member of the board since 2006.

Randy Rolando was appointed outside director in 2008. Mr. Rolando served previously on the board from 1999 to 2004 as an outside director. He has been employed the past 20 years by the Rio Grande Valley Sugar Growers, Inc. as controller and CFO. Mr. Rolando serves as chairman of the Audit Committee.

Francis L. Phillipp was appointed outside director in 2008. Mr. Phillipp previously served on the board from 1976 through 2006. He serves as a member of the Cameron County Appraisal District Agricultural Advisory Board and served as a past chairman of the Cameron County Agricultural Stabilization and Conservation Services. Mr. Phillipp farms in Cameron County. His term expires in 2011.

Reagan Florence, chief executive officer/president, joined the Association in 1990 as a loan officer. He has served as a branch manager, chief lending officer, president and the chief executive officer/president. Mr. Florence left the Association in February 2009.

Wilbron Stanteen, chief financial officer, joined the Association in 2007 and is a certified public accountant. Mr. Stanteen has over 40 years of experience in public accounting and as a CFO for financial institutions. Mr. Stanteen retired from the Association in March 2009.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors were compensated for their service to the Association in the form of an honorarium at the rate of \$500 to \$600 per day for director meetings and committee meetings, and they were reimbursed for certain expenses incurred while representing the Association in an official capacity. Mileage for attending official meetings during 2008 was paid at the IRS-approved rate of 50.5 cents per mile through June 30, 2008 and 58.5 cents per mile from July 1, 2008 through December 31, 2008. A copy of the travel policy is available to stockholders of the Association upon request.

Director	Number of Days Served Associated With		Total Compensation in 2008
	Board Meetings	Other Official Activities	
Bob Ed Stewart	12	23	\$20,200
William (Bill) Barfield	12	22	19,700
Jack Harbison, Jr.	12	19	18,000
Billie Mack Simpson	12	20	18,600
Randy Rolando	1	3	2,000
Francis L. Phillipp	4	7	6,000
Jack C. Ewing	10	9	11,200
			\$95,700

Jack Ewing resigned in November and was replaced by Randy Rolando. Francis Phillipp was invited to merger meetings in January and elected as an advisory board member in December.

The aggregate compensation paid to directors in 2008, 2007 and 2006 was \$95,700, \$54,300 and \$64,375, respectively. Additional detail regarding director compensation paid for committee service (which is included in the table above) is as follows:

Director	Committee		
	Other Official Activities	Audit	Compensation
Bob Ed Stewart	\$13,300	\$--	\$--
William (Bill) Barfield	12,300	--	--
Jack Harbison, Jr.	11,000	--	--
Billie Mack Simpson	11,700	--	--
Randy Rolando	1,500	--	--
Francis L. Phillipp	3,900	--	--
Jack C. Ewing	5,400	--	--
	\$59,100	\$--	\$--

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$51,082, \$18,696 and \$24,962 in 2008, 2007 and 2006, respectively.

Name of Individual or Group	Year	Salary	Bonus	Deferred/ Perquisite	Other	Total
Larry Wade	2008	\$ 61,667	\$ 40,500	\$ -	\$ -	\$ 102,167
Reagan Florence	2008	87,500	14,583	-	-	102,083
Larry Wade	2007	137,956	24,500	2,199	-	164,655
Larry Wade	2006	128,635	-	-	2,965	131,600
Aggregate No. of Senior Officers in Year (Excluding CEO)						
4	2008	\$ 290,833	\$ 46,917	\$ -	\$ -	\$ 337,750
4	2007	330,592	71,000	4,708	-	406,300
4	2006	264,435	80,000	5,025	4,631	354,091

Larry Wade retired June 1, 2008 and was replaced by Reagan Florence as CEO.

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other officer included in the aggregate are available and will be disclosed to shareholders of the institution upon request.

Total compensation paid to the five most highly paid officers of the Association, including bonuses, was \$545,000, \$570,955 and \$485,691 in 2008, 2007 and 2006, respectively. Bonuses paid to such officers for 2008, 2007 and 2006 were \$102,000, \$95,500 and \$80,000, respectively.

Employees assigned Association automobiles reimburse the Association for personal miles at a board-established rate. Employees who use their personal automobile for business purposes were reimbursed during 2008 at the IRS-approved rate of 50.5 cents per mile through June 30, 2008 and 58.5 cents per mile from July 1, 2008 through December 31, 2008.

Total bonuses to officers and employees are calculated using a formula based on profits of the Association and ROA. The individual amounts paid are based on performance and approved by the Board of Directors.

TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 10 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

The Association has no senior officers or directors with any involvement in certain legal proceedings as described in FCA §620.5(k).

RELATIONSHIP WITH INDEPENDENT AUDITOR

PricewaterhouseCoopers LLP was engaged to audit the consolidated financial statements of the Association at December 31, 2008 and for the year then ended at an estimated fee of \$36,500, exclusive of out-of-pocket expenses. The audit engagement was approved by the Audit Committee.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated May 28, 2009, and the report of management in this annual report to stockholders, are incorporated herein by reference.

**CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS
OR HARVESTERS OF AQUATIC PRODUCTS**

The Association has established a policy related to providing credit and services to young, beginning, and small (YBS) farmers and ranchers. “Young” farmers and ranchers are defined as producers under the age of 35. “Beginning” farmers and ranchers are producers that have been on the farm or ranch for less than 10 years. A producer is considered a “Small” farmer and rancher if his or her gross agricultural sales are less than \$250,000.

The Association created an YBS mission statement to help guide its efforts. The mission statement is as follows:

“AgCredit of South Texas, ACA will finance the creditworthy needs of all young, beginning and small farmers, ranchers and producers of aquatic products with specifically designed credit programs and services to include special underwriting or other credit enhancements not to exceed the Association’s risk-bearing ability based on the overall portfolio.

The Association is committed to cooperating with all farm credit institutions, state and federal agencies, such as the United States Department of Agriculture and Small Business Administration, commercial lending institutions and all other guarantors or cosigners to benefit young, beginning and small producers. It has committed staff and financial resources to the development and execution of its YBS program.

Each year the Association establishes objectives related to its YBS program. The objectives are approved by the board of directors and are included in the Association’s strategic plan. The following table summarizes the Association’s 2008 objectives compared to actual results.

YBS Program	2008 Objective	2008 Result
New young farmer and rancher loan volume	\$8,243,000	\$6,620,000
New beginning farmer and rancher loan volume	\$16,893,000	\$23,615,000
New small farmer and rancher loan volume	\$17,467,000	\$27,487,000

Based on the USDA-NASS 2002 Census, the latest data available, the Association had YBS demographics as follows:

YBS Program	Territory	Association
New young farmer and rancher	4.5%	9.0%
New beginning farmer and rancher	30.7%	39.9%
New small farmer and rancher	96.1%	39.8%