

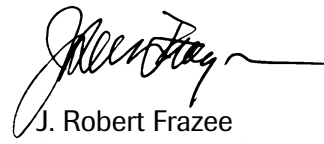
# THIRD QUARTER 2009

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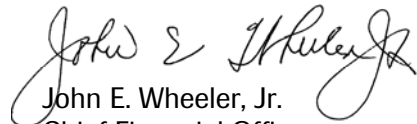
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## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2009 quarterly report of MidAtlantic Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



J. Robert Frazee  
Chief Executive Officer



John E. Wheeler, Jr.  
Chief Financial Officer



Fred Moore, Jr.  
Chairman of the Board

October 29, 2009

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*MidAtlantic Farm Credit, ACA*

# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2009. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of September 30, 2009, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2009



J. Robert Frazee  
Chief Executive Officer



John E. Wheeler, Jr.  
Chief Financial Officer

October 29, 2009

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of MidAtlantic Farm Credit, ACA (Association) for the period ended September 30, 2009. On November 25, 2008, the stockholders of Valley Farm Credit, ACA and MidAtlantic Farm Credit, ACA approved a merger (Merger) to merge Valley into MidAtlantic; the FCA granted its final approval of the Merger on December 31, 2008 and the Merger was effective on December 31, 2008. The information contained herein reflects the merged entity for periods prior to December 31, 2008. The comments contained in this report should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2008 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for the financing of short- and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio encompasses a well diversified range of agricultural commodities, with cash grains, poultry and dairy representing the largest segments. In addition, the Association provides a significant amount of loans to lessors of agricultural real estate. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the opportunities for non-farm income, impacts the level of dependency on any particular commodity.

Gross loans at September 30, 2009 totaled \$2,283,278 compared to \$2,190,189 at December 31, 2008, increasing \$93,089 (4.25 percent) during the first nine months. The Association's allowance for loan losses of \$20,420 increased \$3,437 (20.24 percent) during the first nine months of 2009 resulting in net loans (gross loans less allowance for loan losses) of \$2,262,858 and \$2,173,206 at September 30, 2009 and December 31, 2008, respectively. Nonaccrual loans increased \$8,688 (19.24 percent) from \$45,158 at December 31, 2008 to \$53,846 at September 30, 2009 resulting in an increase in the ratio of Nonaccrual loans to total loans from 2.06 percent to 2.36 percent.

There is an inherent risk in the extension of any type of credit and, accordingly, the Association maintains an

allowance for loan losses consistent with the risk measured in the portfolio.

Credit administration remains satisfactory and while the credit quality has experienced deterioration due to general economic conditions, the overall credit quality of the Association's loan portfolio has remained acceptable. A provision for loan losses of \$2,000, \$2,500 and \$4,500 was recorded in the first, second, and third quarters of 2009, respectively, that after giving effect to the net impact of charge-offs, increased the Association's allowance \$3,437 as of September 30, 2009. The allowance for loan losses represented 0.89 percent and 0.77 percent of total loans at September 30, 2009 and December 31, 2008, respectively. See also Note 2 of "Notes to the Consolidated Financial Statements".

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2009***

Net income for the three months ended September 30, 2009 totaled \$6,783, a decrease of \$4,009 (37.15 percent) compared to the three months ended September 30, 2008. Major changes in the components of net income are identified as follows:

- Net interest income increased \$576 (4.19 percent) for the quarter ended September 30, 2009 compared to the same period in 2008. The increase in net interest income is primarily attributable to incremental earnings on an increasing loan portfolio as loan volume increased \$99 million (4.53 percent) from September 30, 2008 and net of a slightly increased portfolio margin attributable to the decrease in interest rates which occurred over the past year. This was partially offset by a \$616 decrease in the Association's earnings credit in its equity due to the sharp decrease in interest rates during the past twelve months.
- The risks identified in the Association's loan portfolio required a provision for loan losses of \$4,500 to be recorded in the third quarter of 2009 whereas a provision of \$1,500 was recorded in the third quarter of 2008. Two large loans which required a specific reserve accounted for approximately one-half of the provision for the quarter. The remaining provision includes loans in

industry sectors which have been particularly stressed by the economic downturn such as the timber related sector as well as the elements of the overall portfolio. The Association's delinquent loans increased from .79 percent at December 31, 2008 to 1.16 percent of the portfolio at September 30, 2009. See also Note 2 of "Notes to the Consolidated Financial Statements".

- At September 30, 2009 and 2008, the Association accrued an estimated patronage receipt (reported as "Equity in earnings of other Farm Credit institutions" on the Consolidated Statements of Income) of \$3,861 and \$3,709, respectively, which is based on third quarter operations only; management anticipates additional income for the fourth quarter in 2009. Since this income from AgFirst Farm Credit Bank (the Bank) is reasonably estimable and because there is a history of these earnings, management is of the opinion that including this income in quarterly operations provides shareholders with a more accurate forecast of annualized net income.
- Noninterest income in the third quarter of 2009 included a net increase in fee related income of \$175, decreases on net home loan sales of \$62 and an increase in other noninterest income of \$49.
- Noninterest expense for the third quarter of 2009 was \$8,964 as compared to \$7,134 for the third quarter of 2008 or an increase of \$1,830 (25.65 percent). The increase of \$1,808 for Salaries and employee benefits includes a \$1,237 employee benefits variance primarily attributable to an increase in pension related expenses due to the adverse impact of the economic downturn on the District's pension investment portfolio. The magnitude of this difference as compared to 2008 is expected to continue throughout 2009. The remaining Salaries and employee benefits variance of \$571 is primarily attributable to severance related expenses resulting from the Merger and normal merit increases.

Insurance fund premium expense increased \$277 (40.80 percent) resulting from the increased loan portfolio and an increase in the insurance premium for loans as determined by the Farm Credit System Insurance Corporation (FCSIC) for 2009.

Occupancy and equipment and Other operating expenses decreased \$255 from \$2,188 to \$1,933 illustrating the Association's cost management, particularly in a challenging economic environment, and realization of some operating efficiencies attributable to the Merger.

### ***For the nine months ended September 30, 2009***

Net income for the nine months ended September 30, 2009 totaled \$21,017 or \$10,109 (32.48 percent) less than the nine months ended September 30, 2008. Year-to-date operations for the Association simulated third quarter operations. Major changes in the components of net income are identified as follows:

- The increase in net interest income of \$473 (1.15 percent) is primarily attributable to a \$2.4 million favorable increase in volume and a \$1.8 million favorable increase in net margin, which was offset by a \$2.5 million decrease in earnings credit on the Association's equity due to lower interest rates and a \$1.2 million unfavorable impact attributable to the increase in nonaccrual loan volume.
- Charge-offs and risks identified in the Association's loan portfolio required a provision for loan losses of \$9,000 to be recorded in the first nine months of 2009 as compared to a \$2,838 provision in the first nine months of 2008.
- At the period ended September 30, 2009, the Association accrued an estimated patronage receipt of \$11,420 as compared to \$10,679 at September 30, 2008. This accrual is based on the first nine months of operations only; management anticipates additional income for the fourth quarter in 2009. Since this income from the Bank is reasonably estimable and because there is a history of these earnings, management is of the opinion that including this income in quarterly operations provides shareholders with a more accurate forecast of annualized net income.
- Noninterest income included an increase in fee income of \$740. As fees are common practice in a marketplace, the Association utilizes this vehicle to help achieve an acceptable return on its capital. The Association also received additional income from its crop insurance program based on claims experience.
- Noninterest expense increased \$5,349 (24.73 percent) for the first nine months of 2009 as compared to 2008. The year-to-date increase for Salaries and employee benefits of \$5,093 (39.18 percent) includes a \$3,809 employee benefits variance primarily attributable to an increase in pension related expenses due to the adverse impact of the economic downturn on the District's pension investment portfolio. The magnitude of this difference as compared to 2008 is expected to continue throughout 2009. The remaining Salaries and employee benefits variance of \$1,284 includes

\$775 of severance related expenses attributable to the Merger.

Insurance fund premium expense increased \$624 (28.73 percent) resulting from the increased loan portfolio, an increase in loan types which require higher premiums and an overall increase in the insurance premium for loans as determined by FCSIC for 2009.

Occupancy and equipment and Other operating expenses decreased \$368 from \$6,455 to \$6,087 illustrating the Association's cost management, particularly in a challenging economic environment, the favorable impact of travel related expenses attributable to the decrease in fuel costs and efficiencies being realized in connection with the Merger.

- The Provision for income taxes in 2009 includes the impact of a deferred tax asset valuation allowance.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sectors. The Association utilizes the variable rate note to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total Notes payable to the Bank at September 30, 2009 was \$1,944,724 compared to \$1,852,726 at December 31, 2008. This increase during the period of \$91,998 (4.97 percent) corresponds to the augmentation in the Association's loan volume, receipt of prior year Bank patronage, offset by current year net cash generated from operating activities and patronage payments to stockholders.

## CAPITAL RESOURCES

Members' equity at September 30, 2009 totaled \$368,867 an increase of \$15,307 (4.33 percent) compared to total members' equity of \$353,560 at December 31, 2008. Net income of \$21,017 for the nine months ended September 30, 2009 and net member capital stock/participation certificates retired of \$424, an estimated cash patronage distribution

accrual for the first nine months of 2009 totaling \$5,311, and other net adjustments of \$3 account for the change.

FCA regulations require that all Farm Credit institutions maintain a minimum permanent capital ratio of 7.0 percent and total surplus and core surplus ratios equal to 3.5 percent. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. At September 30, 2009, the Association's permanent capital, total surplus and core surplus ratios equaled 14.18 percent, 13.72 percent and 11.47 percent, respectively.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-333-7950, or writing John E. Wheeler, Jr., Chief Financial Officer, MidAtlantic Farm Credit, ACA, P.O. Box 770, Westminster, MD 21158-0770, or accessing the website, [www.mafc.com](http://www.mafc.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# MidAtlantic Farm Credit, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>September 30, 2009</b> <i>(unaudited)</i>	<b>December 31, 2008</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 377	\$ 1,550
Loans	2,283,278	2,190,189
Less: allowance for loan losses	20,420	16,983
Net loans	2,262,858	2,173,206
Accrued interest receivable	17,290	14,451
Investment in other Farm Credit institutions	30,145	29,991
Premises and equipment, net	14,597	14,963
Other property owned	210	—
Due from AgFirst Farm Credit Bank	11,403	14,397
Other assets	8,746	12,148
Total assets	\$ 2,345,626	\$ 2,260,706
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,944,724	\$ 1,852,726
Accrued interest payable	5,872	6,881
Patronage refund payable	5,360	13,449
Allocated surplus payable	—	11,353
Other liabilities	20,803	22,737
Total liabilities	1,976,759	1,907,146
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	11,152	11,576
Retained earnings		
Allocated	157,271	156,869
Unallocated	200,821	185,520
Accumulated other comprehensive income (loss)	(377)	(405)
Total members' equity	368,867	353,560
Total liabilities and members' equity	\$ 2,345,626	\$ 2,260,706

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

MidAtlantic Farm Credit, ACA

# Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008 <sup>1</sup></b>	<b>2009</b>	<b>2008 <sup>1</sup></b>
<b>Interest Income</b>				
Loans	\$ 32,152	\$ 35,593	\$ 97,130	\$ 106,290
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	17,845	21,862	55,488	65,121
Net interest income	14,307	13,731	41,642	41,169
Provision for (reversal of allowance for) loan losses	4,500	1,500	9,000	2,838
Net interest income after provision for (reversal of allowance for) loan losses	9,807	12,231	32,642	38,331
<b>Noninterest Income</b>				
Loan fees	601	315	1,816	1,231
Fees for financially related services	1,231	1,342	1,662	1,507
Equity in earnings of other Farm Credit institutions	3,861	3,709	11,420	10,679
Gains (losses) on other property owned, net	(5)	31	(5)	35
Gains (losses) on sale of rural home loans, net	144	206	723	673
Other noninterest income	108	59	396	340
Total noninterest income	5,940	5,662	16,012	14,465
<b>Noninterest Expense</b>				
Salaries and employee benefits	6,075	4,267	18,092	12,999
Occupancy and equipment	624	613	1,911	1,890
Insurance Fund premium	956	679	2,796	2,172
Other operating expenses	1,309	1,575	4,176	4,565
Total noninterest expense	8,964	7,134	26,975	21,626
Income before income taxes	6,783	10,759	21,679	31,170
Provision (benefit) for income taxes	—	(33)	662	44
Net income	\$ 6,783	\$ 10,792	\$ 21,017	\$ 31,126

<sup>1</sup> Amounts reflect the combined accounts and operations of MidAtlantic and Valley.

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

MidAtlantic Farm Credit, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

<i>(dollars in thousands)</i>	<b>Capital Stock and Participation Certificates <sup>1</sup></b>	<b>Retained Earnings</b>		<b>Accumulated Other Comprehensive Income <sup>1</sup></b>	<b>Total Members' Equity <sup>1</sup></b>
		<b>Allocated <sup>1</sup></b>	<b>Unallocated <sup>1</sup></b>		
Balance at December 31, 2007	\$ 11,601	\$ 147,803	\$ 182,603	\$ (443)	\$ 341,564
Comprehensive income					
Net income			31,126		31,126
Employee benefit plans adjustments			(26)	33	<u>7</u>
Total comprehensive income					31,133
Capital stock/participation certificates issued/(retired), net	(30)				(30)
Dividends declared/paid					
Patronage distribution					
Cash			(9,156)		(9,156)
Retained earnings retired		(401)			(401)
Patronage distribution adjustment		333	(857)		<u>(524)</u>
Balance at September 30, 2008	<u>\$ 11,571</u>	<u>\$ 147,735</u>	<u>\$ 203,690</u>	<u>\$ (410)</u>	<u>\$ 362,586</u>
Balance at December 31, 2008	\$ 11,576	\$ 156,869	\$ 185,520	\$ (405)	\$ 353,560
Comprehensive income					
Net income			21,017		21,017
Employee benefit plans adjustments				28	<u>28</u>
Total comprehensive income					21,045
Capital stock/participation certificates issued/(retired), net	(424)				(424)
Patronage distribution					
Cash			(5,311)		(5,311)
Retained earnings retired		(5)			(5)
Patronage distribution adjustment		407	(405)		<u>2</u>
Balance at September 30, 2009	<u>\$ 11,152</u>	<u>\$ 157,271</u>	<u>\$ 200,821</u>	<u>\$ (377)</u>	<u>\$ 368,867</u>

<sup>1</sup> Amounts reflect the combined accounts and operations of MidAtlantic and Valley.

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

## Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

### **NOTE 1 – ORGANIZATION, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

The accompanying financial statements include the accounts of MidAtlantic Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2008, are contained in the 2008 Annual Report to Shareholders. These unaudited third quarter 2009 consolidated financial statements should be read in conjunction with the 2008 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with accounting principles generally accepted in the United States (GAAP) and prevailing practices within the banking industry. The results for the nine months ended September 30, 2009, are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2009, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2008 Annual Report to Shareholders, effective January 1, 2009, the Association adopted accounting guidance for fair value measurements of nonfinancial assets and nonfinancial liabilities. The impact of adoption resulted in additional fair value disclosures (see Note 5), primarily regarding other property owned, but does not have an impact on the Association's financial condition or results of operations.

In April 2009, the Financial Accounting Standards Board (FASB) issued guidance, "Interim Disclosures about Fair Value of Financial Instruments." This guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The Association adopted this guidance effective June 30, 2009 (see Note 6).

In May 2009, the FASB issued guidance, "Subsequent Events," which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). Recognized subsequent events should be included in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not included in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was adopted by the Association effective June 30, 2009 (see Note 7).

In June 2009, the FASB issued guidance, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles." This Codification became the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. This guidance was adopted by the Association effective July 1, 2009 and had no impact on the Association's financial condition or results of operations.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

	<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Balance at beginning of period	\$16,983	\$11,556
Provision for (reversal of) loan losses	9,000	1,837
Charge-offs	(5,974)	(1,186)
Recoveries	411	56
Balance at end of period	<u>\$20,420</u>	<u>\$12,263</u>

The following table presents information concerning impaired loans as of September 30,

	<b>2009</b>	<b>2008</b>
Impaired loans with related allowance	\$ 27,202	\$ 8,258
Impaired loans with no related allowance	27,655	15,947
Total impaired loans	<u>\$ 54,857</u>	<u>\$ 24,205</u>
Allowance on impaired loans	<u>\$ 8,693</u>	<u>\$ 3,903</u>

The following table summarizes impaired loan information for the nine months ended September 30,

	<b>2009</b>	<b>2008</b>
Average impaired loans	\$ 48,442	\$ 18,518
Interest income recognized on impaired loans	303	240

## NOTE 3 – EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

	<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Pension	\$ 4,498	\$ 670
401(k)	354	277
Other postretirement benefits	603	441
Total	<u>\$ 5,455</u>	<u>\$1,388</u>

The following is a table of non-qualified retirement and other postretirement benefit contributions for the Association:

	<b>Actual YTD Through 9/30/09</b>	<b>Projected Contributions For Remainder of 2009</b>	<b>Projected Total Contributions 2009</b>
Pension	\$ 9	\$ 3	\$ 12
Other postretirement benefits	299	141	440
Total	<u>\$ 308</u>	<u>\$ 144</u>	<u>\$ 452</u>

As of September 30, 2009, no contributions have been made for 2009 by the Association to the qualified District pension plan in which the Association participates. Actuarial calculations as of the last plan measurement date (December 31, 2008) projected total contributions of \$52.0 million to the qualified District pension plan for all participating institutions for 2009. The funding policy for this plan is to fund the accumulated benefit obligation (ABO) service cost plus the seven year amortization of the unfunded ABO using the discount rate determined as of December 31st of the preceding year. This aggregate contribution will be allocated to the participating District institutions, including the Association, based upon each institution's pro rata share of ABO service cost. Market conditions could impact discount rates and return on plan assets which could make additional contributions necessary before the next plan measurement date of December 31, 2009.

Further details regarding employee benefit plans are contained in the 2008 Annual Report to Shareholders.

## NOTE 4 – MERGER OF MIDATLANTIC FARM CREDIT, ACA AND VALLEY FARM CREDIT, ACA

Effective December 31, 2008, Valley Farm Credit, ACA (Valley) merged into MidAtlantic Farm Credit, ACA (MidAtlantic). The Merger was accounted for at historical cost in a manner similar to a pooling of interests and, accordingly, the Association's financial statements have been restated to include the accounts and operations of both associations for all periods prior to the Merger. The merged Association succeeded to all rights and obligations of the two former associations pursuant to the Merger. The accounting practices used by the former associations were consistent in all material respects. Certain reclassifications were made to conform financial statement presentation. Inter-company transactions between the former associations were immaterial.

## NOTE 5 – FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of assets held in trust funds, standby letters of credit, impaired loans, and other property owned.

This guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

This guidance establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels of inputs and the classification of the Association's financial instruments within the fair value hierarchy are as follows:

### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at September 30, 2009 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

### Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets or liabilities measured at fair value on a recurring basis at September 30, 2009.

### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets at September 30, 2009 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than

the principle balance of the loan, a specific reserve is established. Other property owned is classified as a Level 3 asset at September 30, 2009. The fair value for other property owned is based upon the collateral less estimated costs to sell. Level 3 liabilities at September 30, 2009 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at September 30, 2009 for each of the fair value hierarchy levels:

	September 30, 2009			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets:</b>				
Assets held in trust funds	\$ 480	\$ -	\$ -	\$ 480
Total Assets	\$ 480	\$ -	\$ -	\$ 480
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 357	\$ 357
Total Liabilities	\$ -	\$ -	\$ 357	\$ 357

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 298
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	59
Transfers in and/or out of level 3	-
Balance at September 30, 2009	\$ 357

### Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

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

	September 30, 2009			Total Fair Value	YTD Total Gains (Losses)
	Level 1	Level 2	Level 3		
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 18,509	\$ 18,509	\$ (5,779)
Other property owned	\$ -	\$ -	\$ 210	\$ 210	\$ -

**NOTE 6 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following table presents the carrying amounts and fair values of the Association’s financial instruments at September 30, 2009.

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, 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 are as follows:

	<b>September 30, 2009</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
<b>Financial assets:</b>		
Cash	\$ 377	\$ 377
Loans, net of allowance	\$ 2,262,858	\$ 2,309,229
Assets held in trust funds	\$ 480	480
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,944,724	\$ 1,979,771

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 Bank’s loan rates, as well as 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 based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association’s investment in the Bank is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 7.82 percent of the issued stock of the Bank as of September 30, 2009 net of any reciprocal investment. As of that date, the Bank’s assets totaled \$30.08 billion and shareholders’ equity totaled \$1.60 billion. The Bank’s earnings were \$194.0 million during the first nine months of 2009.
- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association’s loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association’s interest margin are used to fund operating expenses and capital expenditures.
- E. **Commitments to Extend Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.
- F. **Assets Held in Trust Funds:** See Note 5 for discussion of estimation of fair value for this instrument.

**NOTE 7 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events and has determined there are none requiring disclosure through November 3, 2009, which is the date the financial statements were available to be issued.