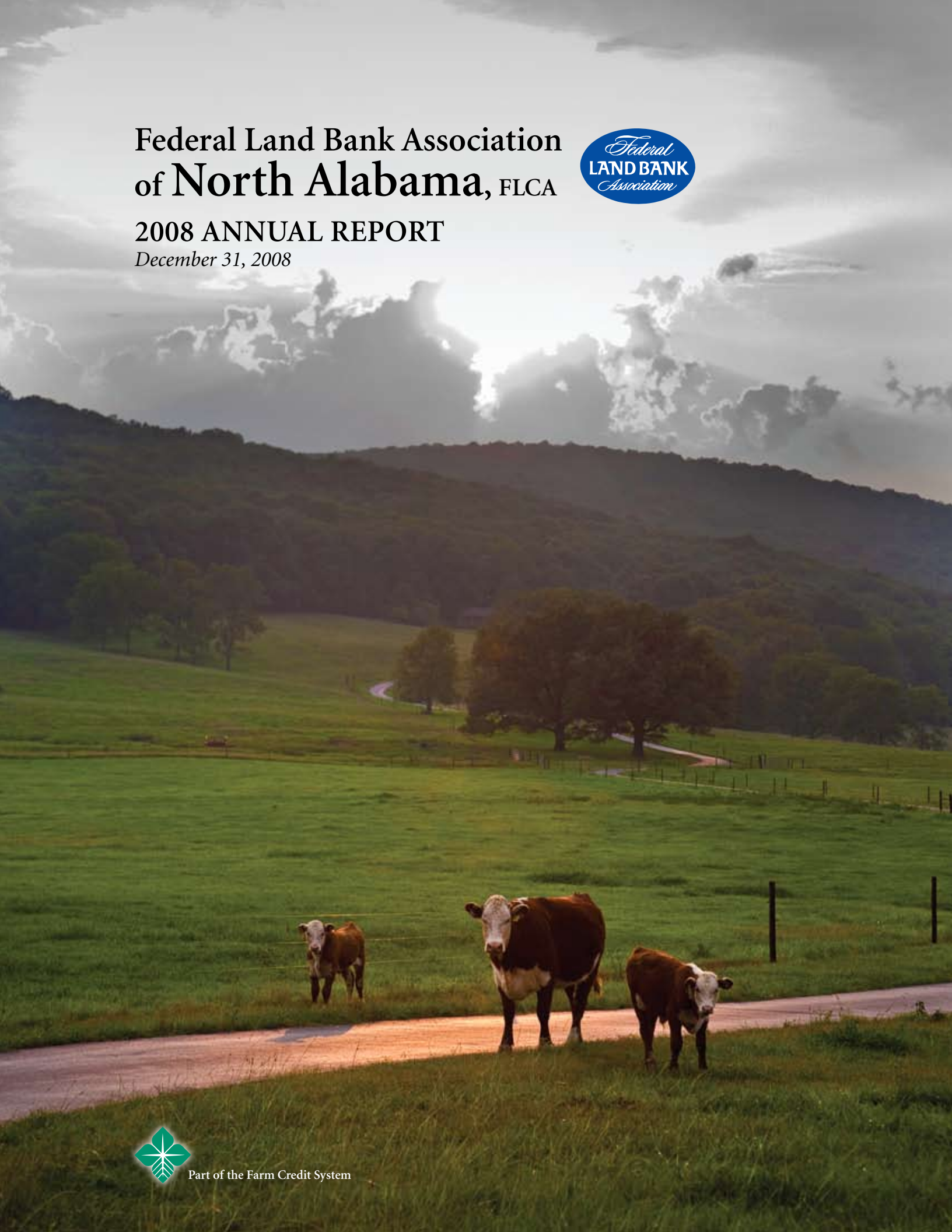


Federal Land Bank Association
of **North Alabama**, FLCA



2008 ANNUAL REPORT

December 31, 2008



Part of the Farm Credit System

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REPORT OF MANAGEMENT

The financial statements of FLBA of North Alabama, FLCA (Association) are prepared by management, who are responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The 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 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 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 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 his or her knowledge or belief.



K. Ben Gore, Chief Executive Officer/ President

March 4, 2009



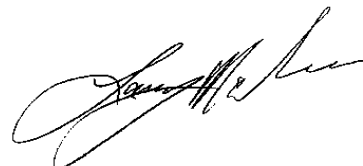
Loyd Rutherford, Chairman, Board of Directors

March 4, 2009



Karri H. Sumrall, Chief Financial Officer/Sr. Vice President

March 4, 2009



Larry McGee, Chairman, Audit Committee

March 4, 2009

REPORT OF AUDIT COMMITTEE

The Audit Committee (Committee) is composed of Larry Don McGee, Chairman, John R. Adams, CPA, and Matthew Christjohn who are directors of FLBA of North Alabama, FLCA. In 2008, five Committee meetings were held. The Committee oversees the scope of FLBA of North Alabama, FLCA'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 FLBA of North Alabama, FLCA's web site. The Committee approved the appointment of PricewaterhouseCoopers LLP for 2008.

Management is responsible for FLBA of North Alabama, FLCA's internal controls and the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America. The financial statements are prepared under the oversight of the Committee. PricewaterhouseCoopers is responsible for performing an independent audit of FLBA of North Alabama, FLCA's 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.

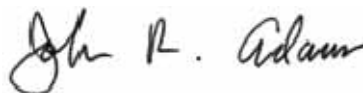
In this context, the Committee reviewed and discussed FLBA of North Alabama, FLCA's audited financial statements for the year ended December 31, 2008 (audited financial statements) with management and PricewaterhouseCoopers. The Committee also reviews with PricewaterhouseCoopers the matters required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

The Committee discussed with PricewaterhouseCoopers its independence from FLBA of North Alabama, FLCA. The Committee also reviewed the non-audit services provided by PricewaterhouseCoopers and concluded that these services were not incompatible with maintaining the independent accountant's independence. The Committee has discussed with management and PricewaterhouseCoopers 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 financial statements in FLBA of North Alabama, FLCA's Annual Report to Stockholders for the year ended December 31, 2008.



Larry Don McGee, Chairman
March 4, 2009



John R. Adams, CPA, Member
March 4, 2009



Matthew Christjohn, DVM, Member
March 4, 2009

FLBA OF NORTH ALABAMA, FLCA

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

	December 31,				
	2008	2007	2006	2005	2004
<u>Balance Sheet Data</u>					
<u>Assets</u>					
Cash	\$ 15	\$ 1,140	\$ 1,237	\$ 497	\$ 37
Loans	416,516	388,046	363,103	335,321	293,269
Less: allowance for loan losses	509	402	229	117	128
Net loans	416,007	387,644	362,874	335,204	293,141
Investment in and receivable from the Bank	7,471	6,415	5,926	5,289	4,836
Other property owned, net	99	11	-	-	184
Other assets	8,396	8,351	7,972	6,779	5,040
Total assets	<u>\$ 431,988</u>	<u>\$ 403,561</u>	<u>\$ 378,009</u>	<u>\$ 347,769</u>	<u>\$ 303,238</u>
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 5,104	\$ 4,878	\$ 2,592	\$ 2,652	\$ 1,811
Obligations with maturities greater than one year	361,621	338,554	314,565	291,687	250,385
Total liabilities	<u>366,725</u>	<u>343,432</u>	<u>317,157</u>	<u>294,339</u>	<u>252,196</u>
<u>Members' Equity</u>					
Capital stock and participation certificates	2,460	2,375	2,249	2,173	6,426
Unallocated retained earnings	62,529	57,374	58,603	51,257	44,616
Accumulated other comprehensive income	274	380	-	-	-
Total members' equity	<u>65,263</u>	<u>60,129</u>	<u>60,852</u>	<u>53,430</u>	<u>51,042</u>
Total liabilities and members' equity	<u>\$ 431,988</u>	<u>\$ 403,561</u>	<u>\$ 378,009</u>	<u>\$ 347,769</u>	<u>\$ 303,238</u>
<u>Year Ended December 31,</u>					
<u>Statement of Income Data</u>					
Net interest income	\$ 11,634	\$ 11,218	\$ 10,651	\$ 9,488	\$ 8,151
(Provision for loan losses) or loan loss reversal	(108)	(4,988)	(112)	16	5,327
Income from the Bank	1,370	1,308	1,182	1,018	624
Other noninterest income	1,360	1,062	1,078	1,038	848
Noninterest expense	(6,351)	(5,248)	(4,727)	(4,296)	(5,025)
Extraordinary items	-	-	-	-	-
Net income	<u>\$ 7,905</u>	<u>\$ 3,352</u>	<u>\$ 8,072</u>	<u>\$ 7,264</u>	<u>\$ 9,925</u>
<u>Key Financial Ratios for the Year</u>					
Return on average assets	1.9%	0.9%	2.3%	2.2%	3.4%
Return on average members' equity	12.4%	5.5%	14.3%	13.6%	22.5%
Net interest income as a percentage of average earning assets	2.9%	3.0%	3.1%	3.0%	2.9%
Net charge-offs as a percentage of average loans	0.0%	1.3%	0.0%	0.0%	0.0%

FLBA OF NORTH ALABAMA, FLCA

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	15.1%	14.9%	16.1%	15.4%	16.8%
Debt as a percentage of members' equity	561.9%	571.2%	521.2%	550.9%	494.1%
Allowance for loan losses as a percentage of loans	0.1%	0.1%	0.1%	0.0%	0.0%
Permanent capital ratio	16.5%	16.3%	16.8%	17.0%	16.5%
Core surplus ratio	15.8%	15.6%	16.1%	15.3%	13.9%
Total surplus ratio	15.8%	15.6%	16.1%	15.3%	13.9%
<u>Net Income Distribution</u>					
Cash dividends paid	\$ -	\$ -	\$ -	\$ 623	\$ 635
Patronage refunds:					
Cash	2,394	2,181	726	-	-

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 financial condition and results of operations of FLBA of North Alabama, FLCA for the years ended December 31, 2008, 2007 and 2006, and should be read in conjunction with the accompanying 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:

During 2007, the Association had a participation loan (the "Loan"), along with 13 other Farm Credit associations, with an original funded balance of \$68,500,000, and the Association's portion of the participation was 5.56 percent. During the second quarter of 2007, the loan was deemed nonaccrual status due to its significant undercollateralized position and a credit default. During 2007, charge-offs of \$30,245,000 were recognized, and specific reserves of \$1,460,000 remain on the books related to this Loan. FLBA of North Alabama's portion of charge-offs and specific reserves were \$4,812,212 and \$279,022, respectively. No further charge-offs or allowance reserves have been required to be recognized throughout 2008. As of December 31, 2008, FLBA of North Alabama's portion of the Loan's remaining book balance is \$461,226. For more information, see the "Purchase and Sale of Loans" and "Legal Proceedings" sections of this Management Discussion and Analysis. For more information on impaired loans and the allowance for loan losses, see Note 3 to the financial statements, "Loans and Allowance for Loan Losses," included in this annual report. For more information on commitments and contingencies, see Note 11 to the financial statements, "Commitments and Contingencies," included in this annual report.

In December 2008, the Association received a direct loan patronage of \$1,051,619 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 \$302,430 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 \$15,559 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 19 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 and farm-related business loans. These loan products are available to eligible borrowers with competitive fixed and indexed-based interest rates. Loan maturities range from five to 40 years,

with 15 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 cash-flow capabilities of the borrower.

The composition of the Association's loan portfolio, including principal less funds held of \$416,516,223, \$388,045,807 and \$363,103,110 as of December 31, 2008, 2007 and 2006, respectively, is described more fully in detailed tables in Note 3 to the financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

The Association's largest commodity concentration in its loan portfolio is poultry, which is approximately 48.8 percent of the total portfolio. Poultry remained mostly stable during 2008; however, the Association began to experience some deterioration in its portfolio as evidenced by a small increase in delinquencies and a decline in credit quality. The industry remained relatively consistent within the market throughout the year, which remains in a downward cycle due to decreased demands and increased input costs. Prices for natural and propane gas continue to put downward pressure on the growers' net income. This is somewhat offset by 2007 increases in grower contracts paid by all the major integrators within the Association's territory. Poultry farm sales during 2008 have seen a fairly stable market. Most integrators continued to expand in the early part of 2008; however, due to an unstable market later in the year, the expansion came to an end. Layout times have increased to the longer end of normal ranges and stocking densities have decreased slightly. These conditions are expected to continue throughout 2009, allowing the market to recover.

One poultry integrator within the Association's territory has filed Chapter 11 bankruptcy restructuring during 2008. At this time, the Association has not seen any adverse effects to growers with Association loans as a result of this financial strain on the integrator. At December 31, 2008, Association loans to growers of this integrator consisted of 339 loans representing \$80.0 million in volume, of which \$29.2 million have government guarantees. The Association will continue to monitor developments within this specific sector of its loan portfolio and properly adjust loan values and any allowance for loan losses to appropriate levels as deemed needed.

Although not as highly publicized currently as in 2006, avian influenza, or bird flu, continues to be of utmost concern to the Association. Poultry growers practice strict bio security measures which are monitored by the State Department of Agriculture and Industries, as well as poultry integrators, to prevent the spread of any disease among the birds. Ongoing testing for disease is done and all poultry is grown in a controlled environment much unlike the conditions overseas where birds and individuals come into close contact with each other. With the present controls in place, the likelihood of bird flu spreading to humans and poultry flocks in North Alabama appears fairly remote.

Drought conditions existed throughout the Association's territory for the majority of the year, reducing overall crop yields still below the 10-year averages. Crop insurance and disaster payments will give some relief, allowing growers to continue. Cattle producers began to see lower demand and lower prices during 2008. Cattle profits also suffered from the drought caused by additional feeding required by a shortage of available grazing and a reduced hay crop. Reduced profits from cattle operations have resulted in limited to no effect on the Association's loan portfolio.

Timber markets in 2008 continued to be depressed due to the decreased demand from the housing market. Indicators for 2009 are for timber prices to remain relatively stable with no evidence of a strong recovery seen at this time. We will continue to work with our borrowers as all market segments make corrections.

Overall land values have remained fairly stable or have seen a slight decline in some areas of the Association territory based on the current economic climate. The agricultural economy, in general for the area, declined in 2008. Unfavorable weather conditions and volatile commodity prices have had a negative effect in stabilizing the farm economy for the year. This can be seen in the Association's slight decrease in credit quality volume at year end.

The probability of higher input costs, questions about future commodity supplies and prices, uncertainty of the export markets and unfolding world events increase the level of financial risk in the farming sector and, correspondingly, the level of credit risk to those financial institutions providing credit to that sector. Given the conditions outlined herein, the quality of the loan portfolio is expected to remain relatively stable or slightly deteriorate throughout 2009. The duration of the conditions described is a concern that has the potential to be more problematic for financial results over the longer term for both the lender and the operator. Continued diligence in the areas of credit controls and monitoring is essential.

At December 31, 2008, the Association held no loans extended under the Rural America Bond Program as approved by the Farm Credit Administration (FCA).

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 \$24,469,024, \$26,210,865 and \$31,498,658, or 5.9 percent, 6.8 percent and 8.7 percent of loans, respectively. Included in these amounts are participations purchased from entities outside the District of \$16,892,992, \$16,783,090 and \$17,811,226, or 4.1 percent, 4.3 percent and 4.9 percent of loans, respectively. The Association had sold no participations as of December 31, 2008, 2007 and 2006, respectively.

In its capacity as the named lead lender and as a member of the Capital Markets of South (CMS), the FLBA of South Alabama, FLCA originated a loan to one borrower and sub-participated the loan (the "Loan") to 13 other Farm Credit associations. Of the 13 associations that participated in the Loan originated by the FLBA of South Alabama, four were members of CMS, and nine participants were non-CMS members. At the time the Loan was originated, FLBA of North Alabama was a member of CMS. The original funded balance of the loan was \$68,500,000 and the Association participated in 5.56 percent of the Loan. In 2007, the Loan was deemed to be nonaccrual due to its significant undercollateralized position and a credit default. The FLBA of South Alabama has been pursuing collection efforts, and in 2007 liquidated part of the Loan's collateral, which was applied towards the outstanding balance for all participants. Also in 2007, FLBA of South Alabama began repurchasing the portions of the Loan held by the non-CMS participant associations. The four other CMS associations, including FLBA of North Alabama, in turn, purchased from the FLBA of South Alabama a pro rata share of the Loan interests formerly held by the non-CMS participants and repurchased by FLBA of South Alabama. As part of the Loan repurchase and purchase transactions noted above, the Association received a general release from the non-CMS participants for claims related to the Loan; however, the non-CMS participants continue to potentially, under certain circumstances, share in certain collections from the borrower. The Association, along with the other four associations that comprised CMS, have agreed to indemnify and hold harmless the non-CMS participants from any liability arising from legal proceedings related to the Loan.

In 2008 collection efforts continued, resulting in legal judgments against the borrowers. This allowed FLBA of South Alabama to foreclose on portions of the real estate collateral, with sales proceeds being applied against the outstanding balance of the Loan for all remaining participants. FLBA of South Alabama is still in process of foreclosing on the remaining portions of the real estate collateral. In addition, the borrowers have surrendered various other real and personal properties, all of which are to be liquidated and applied against the Loan balance of all remaining participants. All sales of remaining real estate collateral and other properties are expected to be completed in the first half of 2009.

During 2007, charge-offs of \$30,245,000 were recognized, and FLBA of North Alabama's portion of the charge-offs was \$4,812,212. No further charge-offs or allowance reserves have been required to be recognized during 2008. As of December 31, 2008, FLBA of North Alabama's portion of the Loan's remaining book balance is \$461,226. Also as of December 31, 2008, total specific reserves of \$1,460,000 remain on the books related to this Loan, of which the Association's portion is \$279,022. For more information on impaired loans and the allowance for loan losses, see Note 3 to the financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

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	\$ 1,430,227	93.5%	\$ 2,247,632	96.6%	\$ 502,134	100.0%
90 days past due and still accruing interest	-	0.0%	67,347	2.9%	-	0.0%
Formally restructured	-	0.0%	-	0.0%	-	0.0%
Other property owned, net	99,076	6.5%	11,200	0.5%	-	0.0%
Total	\$ 1,529,303	100.0%	\$ 2,326,179	100.0%	\$ 502,134	100.0%

At December 31, 2008, 2007 and 2006, loans that were considered impaired were \$1,430,227, \$2,314,979 and \$502,134, representing 0.3 percent, 0.6 percent and 0.1 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. High-risk assets decreased \$796,876 or 34.3 percent, primarily due to funds received on a large participation, as discussed above in the "Purchase and Sales of Loans" section of this Management Discussion and Analysis.

Management will continue to closely monitor high-risk assets in an effort to reduce their impact to the Association and the Bank. 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:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Allowance for loan losses	\$ 509,245	\$ 401,500	\$ 229,568
Allowance for loan losses to total loans	0.1%	0.1%	0.1%
Allowance for loan losses to nonaccrual loans	35.6%	17.9%	45.7%
Allowance for loan losses to impaired loans	35.6%	17.3%	45.7%
Net charge-offs to average loans	0.0%	1.3%	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 \$509,245, \$401,500 and \$229,568 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:

Interest income decreased by \$470,118, or 1.6 percent, compared to 2007, primarily due to declines in yields on earning assets and slightly offset by an increase in average loan volume as a result of the Association's loan growth within its various loan segments. Interest expense for 2008 decreased by \$886,123, or 5.1 percent, compared to 2007 due to a decrease in average debt interest rates offset by an increase in average debt volume outstanding that resulted from the Association's loan growth during the reporting period. The Association's interest rate spread remained at 2.28 percent in 2008 and 2007. The interest rate spread decreased by 11 basis points to 2.28 percent in 2007 from 2.39 percent in 2006, primarily due to the shift in the Association's portfolio composition, competitive conditions, significant increase in nonaccrual volume for the year and the increased rate environment compared to the same period in 2006.

Net interest income for 2008, 2007 and 2006 was \$11,634,236, \$11,218,231 and \$10,650,742, reflecting increases of \$416,005, or 3.7 percent, for 2008 versus 2007 and \$567,489, or 5.3 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:

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Loans	\$ 402,686,506	\$ 28,265,294	\$ 373,407,934	\$ 28,735,412	\$ 344,714,656	\$ 26,087,393
Interest-bearing liabilities	350,580,636	16,631,058	322,962,916	17,517,181	298,258,771	15,436,651
Impact of capital	\$ 52,105,870		\$ 50,445,018		\$ 46,455,885	
Net interest income		\$ 11,634,236		\$ 11,218,231		\$ 10,650,742

	<u>Average Yield</u>	<u>Average Yield</u>	<u>Average Yield</u>
Yield on loans	7.02%	7.70%	7.57%
Cost of interest-bearing liabilities	4.74%	5.42%	5.18%
Interest rate spread	2.28%	2.28%	2.39%

	2008 vs. 2007			2007 vs. 2006		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income	\$ 2,253,103	\$ (2,723,221)	\$ (470,118)	\$ 2,171,450	\$ 476,569	\$ 2,648,019
Interest expense	1,497,958	(2,384,081)	(886,123)	1,278,588	801,942	2,080,530
Net interest income	\$ 755,146	\$ (339,141)	\$ 416,005	\$ 892,862	\$ (325,373)	\$ 567,489

As noted above, the Association's improvement in net interest income is due to higher average loan volume and higher average capital which has supported additional loan volume without the need for additional borrowings, with an offset due to lower interest rates on loan products. The Association's net interest income as a percentage of average earning assets was 2.9 percent, 3.0 percent and 3.1 percent on December 31, 2008, 2007 and 2006, respectively.

Noninterest income for 2008 increased by \$359,895, or 15.2 percent, compared to 2007, due to the Association generating higher fee income from loan conversions and loan growth within its various loan segments. Also, the direct note patronage from the Bank increased due the Association's average direct note balance being higher in 2008 compared to the average balance in 2007. Noninterest income for 2007 increased by \$110,007, or 4.9 percent, compared to 2006, due primarily to an increase in the amount of patronage income received from the Bank, offset somewhat by a small decrease in loan fees generated during the year. The Association received a higher stock credit patronage from the Bank due to the Association's average equity ownership in the Bank being higher in 2007 than in 2006. Also, the direct note patronage from the Bank increased due to the increase in the Association's average direct note balance being higher in 2007 compared to the average balance in 2006.

Operating 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. Noninterest expenses for 2008 increased \$1,102,900 or 21.0 percent. The increase in operating expenses for 2008 compared to 2007 was primarily due to an increase in salaries and employee benefits costs, purchased services expense, travel expense and advertising expense. The increase in salaries and employee benefits is primarily due to having a larger workforce than in the prior year, normal annual increases in compensation rates and an increase in contributions to the defined benefit retirement plan as part of a District-wide initiative to reduce the amount of the unfunded accumulated postretirement benefit obligation. For more information on the defined benefit plan, see Note 2, "Summary of Significant Accounting Policies," to the financial statements included in this annual report. The increase in purchased services expense is primarily due to legal and consulting fees incurred in connection with protecting the Association's interests in credit-related matters with borrowers with large credit from the Association, as noted previously in the "Purchase and Sale of Loans" section of the Management's Discussion and Analysis. The increase in travel costs was due to an increase in the number of Association-owned vehicles, an overall increase in fuel and servicing costs, as well as increased travel costs associated with training. The increase in advertising costs compared to 2007 was due to an amplified effort to penetrate more areas within the Association's lending territory.

Noninterest expenses for 2007 increased \$521,390 or 11.0 percent compared to 2006. This increase was primarily due to an increase in salaries and employee benefits costs, directors' expense, purchased services expense, travel and Farm Credit System Insurance Corporation (FCSIC) premium expense. The increase in salaries and employee benefits is primarily due to having a larger workforce than in the prior year, normal annual increases in compensation rates, and a 1.0 percent increase in the Defined Contribution retirement plan contribution cap from 4.0 percent in 2006 to 5.0 percent in 2007. Director's expenses increased over the same period in 2006 due to the board approving a 2007 monthly retainer fee of \$750 a month per director in addition to their \$500 per meeting honorarium as a result of the increased time requirements and responsibilities as made necessary by the Farm Credit Administration governance regulations effective for 2007. Also as a result of this new regulation, the Association was required to have a director that qualified as a financial expert, which resulted in the Association having an additional director compared to the same period in 2006. Purchased services increased primarily due to legal and consulting fees incurred in connection with protecting the Association's interests in credit-related matters with borrowers with large credit from the Association, as noted previously in the "Purchase and Sale of Loans" section of the Management's Discussion and Analysis. The increase in travel costs was due to an increase in number of Association-owned vehicles, as the Association workforce was increased, and increased travel costs associated with training due to the increased need for new staff training. Farm Credit System Insurance Corporation (FCSIC) premium expense increased due to higher loan balances as of December 31, 2007, compared to loan balances as of December 31, 2006.

The Association's net income for the year ended December 31, 2008, was \$7,904,829 as compared to \$3,351,737 for the year ended December 31, 2007, reflecting an increase of \$4,553,092, or 135.8 percent. The Association's net income for the year ended

December 31, 2006 was \$8,072,032. Net income decreased \$4,720,295, or 58.5 percent, in 2007 versus 2006. The primary reason for the decrease in net income in 2007 is due to the Association recording \$5.0 million in provision for loan losses primarily related to a large participation loan (the "Loan") as discussed in the "Purchase and Sales of Loans" section of this Management Discussion and Analysis which did not occur in 2008 or 2006.

For the year ended December 31, 2008, the Association's return on average assets was 1.9 percent, as compared to 0.9 percent and 2.3 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 12.4 percent, as compared to 5.5 percent and 14.3 percent for the years ended December 31, 2007 and 2006, respectively. The primary reason for the increase from 2007 ratios is the direct result of having no significant provision for loan losses recorded in 2008 or 2006 as occurred in the same reporting period for 2007.

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 \$360,225,253, \$337,026,991 and \$313,168,620 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 4.4 percent, 5.4 percent and 5.4 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 increased funding needs generated by growth in the Association's loan portfolio. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$56,074,371, \$50,982,501 and \$49,671,767 at December 31, 2008, 2007 and 2006, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$420,768,576 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.

Capital Resources:

The Association's capital position remains strong, with total members' equity of \$65,263,557, \$60,129,464 and \$60,851,500 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 16.5 percent, 16.3 percent and 16.8 percent, respectively.

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 15.8 percent, 15.6 percent and 16.1 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, 2007 and 2006 was 15.8 percent, 15.6 percent and 16.1 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent.

In 2008, 2007 and 2006, the Association paid patronage distributions of \$2,393,778, \$2,181,215 and \$726,402, respectively. The Association accrued a \$2,745,000 patronage distribution to its stockholders based on its 2008 obligating patronage resolution that was declared by the board of directors in December 2008. This distribution will be paid in March 2009. See Note 7 to the financial statements, "Members' Equity," included in this annual report, for further information.

Legal Proceedings:

In relation to the Loan described in the "Purchase and Sale of Loans" section of Management's Discussion and Analysis, above, the Association is involved in only one lawsuit as of the date of this report. The overall character of the lawsuit is for damages incurred by FLBA of South Alabama, FLCA as a result of alleged wrongful acts of the borrower and other third-party defendants. FLBA of South Alabama, FLCA brought this civil lawsuit in the U.S. Federal District Court in Texas, the borrower's domicile state, and the trial was held in early February 2009. This court action has been lengthy and the outcome is still unknown at this time. This and other legal proceedings are described in more detail in Note 11 to the financial statements, "Commitments and Contingencies," included in this annual report.

Two other court actions had previously existed on this Loan. The first was in Texas state court and was brought in order to obtain access to collateral for the Loan. This suit was successful and has now been dismissed. The second court action was in Kentucky state court where the FLBA of South Alabama's suit on the debt was pending, as the Loan's primary real estate collateral is located in Kentucky. In mid-September 2008, the Kentucky court granted summary judgment in favor of FLBA of South Alabama for the debt plus interest, costs and fees. This step allowed FLBA of South Alabama to have a foreclosure sale of its real estate collateral located in Bell/Harlan counties, which sale was conducted on October 10, 2008, resulting in a purchase by a third party of such collateral for \$7,001,000. That sale was consummated by the middle of November 2008 and FLBA of South Alabama received \$6,971,336 which was applied against the loan balance of all remaining participants. In February 2009, FLBA of South Alabama received approval to foreclose the lien of its mortgage on real estate collateral held in Muhlenberg County and intends to foreclose such lien in late March or early April 2009. FLBA of South Alabama and all remaining participants have been and will remain vigorous in pursuit of collection of the loan balances outstanding and other potential sources of recovery. All counterclaims asserted by the borrower and others against FLBA of South Alabama have been dismissed in all legal proceedings.

Relationship With the Bank:

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6 to the 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 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 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 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:

The challenging industry and economic conditions facing the Association will require Association management to maintain caution in credit delivery and monitoring and to continue to explore options for diversifying the portfolio, increasing efficiency and streamlining operations where possible. Over the past 19 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 FLBA of North Alabama, FLCA

In our opinion, the accompanying balance sheets and related statements of income, changes in members' equity and cash flows present fairly, in all material respects, the financial position of FLBA of North Alabama, FLCA (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 Association'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
March 4, 2009

FLBA OF NORTH ALABAMA, FLCA

BALANCE SHEET

	December 31,		
	2008	2007	2006
<u>Assets</u>			
Cash	\$ 14,780	\$ 1,139,838	\$ 1,236,541
Loans	416,516,223	388,045,807	363,103,110
Less: allowance for loan losses	509,245	401,500	229,568
Net loans	416,006,978	387,644,307	362,873,542
Accrued interest receivable	6,220,087	6,220,919	5,861,796
Investment in and receivable from the Bank:			
Capital stock	6,969,525	6,415,030	5,926,040
Other	501,737	-	-
Other property owned, net	99,076	11,200	-
Premises and equipment	1,981,748	1,971,932	1,993,318
Other assets	194,400	158,580	117,784
Total assets	\$ 431,988,331	\$ 403,561,806	\$ 378,009,021
<u>Liabilities</u>			
Note payable to the Bank	\$ 360,225,253	\$ 337,026,991	\$ 313,168,620
Accrued interest payable	1,395,788	1,526,703	1,396,031
Drafts outstanding	363,257	698,683	707,851
Patronage payable	2,749,844	2,398,622	-
Other liabilities	1,990,632	1,781,343	1,885,019
Total liabilities	366,724,774	343,432,342	317,157,521
<u>Members' Equity</u>			
Capital stock and participation certificates	2,460,820	2,375,470	2,249,000
Unallocated retained earnings	62,528,869	57,374,400	58,602,500
Accumulated other comprehensive income	273,868	379,594	-
Total members' equity	65,263,557	60,129,464	60,851,500
Total liabilities and members' equity	\$ 431,988,331	\$ 403,561,806	\$ 378,009,021

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

FLBA OF NORTH ALABAMA, FLCA

STATEMENT OF INCOME

	Year Ended December 31,		
	2008	2007	2006
<u>Interest Income</u>			
Loans	\$ 28,265,294	\$ 28,735,412	\$ 26,087,393
<u>Interest Expense</u>			
Note payable to the Bank	16,631,058	17,517,181	15,436,651
Net interest income	<u>11,634,236</u>	<u>11,218,231</u>	<u>10,650,742</u>
<u>Provision for Losses</u>			
Provision for loan losses	107,745	4,988,180	112,122
Net interest income after provision for loan losses	<u>11,526,491</u>	<u>6,230,051</u>	<u>10,538,620</u>
<u>Noninterest Income</u>			
Patronage income from the Bank	1,369,608	1,307,584	1,181,801
Loan fees	1,258,278	971,248	998,625
Financially related services income	39,370	42,103	39,368
Gain on other property owned, net	5,249	-	-
Gain on sale of premises and equipment, net	10,861	14,265	18,353
Other noninterest income	46,188	34,802	21,848
Total noninterest income	<u>2,729,554</u>	<u>2,370,002</u>	<u>2,259,995</u>
<u>Noninterest Expenses</u>			
Salaries and employee benefits	3,579,070	2,830,926	2,672,038
Directors' expense	228,699	220,986	133,764
Purchased services	890,013	640,006	476,809
Travel	328,768	285,264	235,195
Occupancy and equipment	191,458	182,297	186,112
Communications	66,906	61,817	56,067
Advertising	183,845	154,531	157,486
Public and member relations	107,715	109,117	92,451
Supervisory and exam expense	124,535	123,815	120,925
Insurance Fund premiums	518,855	516,942	475,747
Loss on other property owned, net	-	343	-
Other noninterest expense	131,352	122,272	119,989
Total noninterest expenses	<u>6,351,216</u>	<u>5,248,316</u>	<u>4,726,583</u>
Net income	<u>\$ 7,904,829</u>	<u>\$ 3,351,737</u>	<u>\$ 8,072,032</u>

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

FLBA OF NORTH ALABAMA, FLCA

STATEMENT OF CHANGES IN MEMBERS' EQUITY

	Capital Stock/ Participation Certificates	Retained Earnings Unallocated	Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2005	\$ 2,172,920	\$ 51,256,870	\$ -	\$ 53,429,790
Net income	-	8,072,032	-	8,072,032
Capital stock/participation certificates issued	362,180	-	-	362,180
Capital stock/participation certificates and allocated retained earnings retired	(286,100)	-	-	(286,100)
Patronage refunds:				
Cash	-	(726,402)	-	(726,402)
Balance at December 31, 2006	2,249,000	58,602,500	-	60,851,500
Net income	-	3,351,737	-	3,351,737
Adjustment to initially apply SFAS No. 158	-	-	379,594	379,594
Capital stock/participation certificates issued	375,540	-	-	375,540
Capital stock/participation certificates and allocated retained earnings retired	(249,070)	-	-	(249,070)
Patronage refunds:				
Cash	-	(4,579,837)	-	(4,579,837)
Balance at December 31, 2007	2,375,470	57,374,400	379,594	60,129,464
Adjustment to beginning balance due to SFAS No. 158 accounting change	-	(5,360)	-	(5,360)
Balance at January 1, 2008	2,375,470	57,369,040	379,594	60,124,104
Comprehensive income:				
Net income	-	7,904,829	-	7,904,829
Change in postretirement benefits plans	-	-	(105,726)	(105,726)
Total comprehensive income	-	7,904,829	(105,726)	7,799,103
Capital stock/participation certificates issued	400,580	-	-	400,580
Capital stock/participation certificates and allocated retained earnings retired	(315,230)	-	-	(315,230)
Patronage refunds:				
Cash	-	(2,745,000)	-	(2,745,000)
Balance at December 31, 2008	\$ 2,460,820	\$ 62,528,869	\$ 273,868	\$ 65,263,557

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

FLBA OF NORTH ALABAMA, FLCA

STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income	\$ 7,904,829	\$ 3,351,737	\$ 8,072,032
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	107,745	4,988,180	112,122
Gain on other property owned, net	-	(2,050)	-
Depreciation	180,233	176,466	172,390
Gain on sale of premises and equipment, net	(10,861)	(14,265)	(18,353)
Decrease (increase) in accrued interest receivable	832	(359,123)	(1,213,467)
Increase in other receivable from the Bank	(501,737)	-	-
Increase in other assets	(35,820)	(39,246)	(11,119)
(Decrease) increase in accrued interest payable	(130,915)	130,672	257,325
Increase in other liabilities	98,203	275,918	331,154
Net cash provided by operating activities	<u>7,612,509</u>	<u>8,508,289</u>	<u>7,702,084</u>
Cash flows from investing activities:			
Increase in loans, net	(28,569,492)	(29,770,145)	(27,781,820)
Purchase of investment in the Bank	(554,495)	(488,990)	(637,405)
Purchases of premises and equipment	(241,476)	(182,515)	(173,456)
Proceeds from sales of premises and equipment	62,288	41,700	50,487
Proceeds from sales of other property owned	11,200	500	-
Net cash used in investing activities	<u>(29,291,975)</u>	<u>(30,399,450)</u>	<u>(28,542,194)</u>

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

FLBA OF NORTH ALABAMA, FLCA

STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from financing activities:			
Net draws on note payable to the Bank	23,198,262	23,858,371	22,620,219
Decrease in drafts outstanding	(335,426)	(9,168)	(390,641)
Issuance of capital stock and participation certificates	400,580	375,540	362,180
Retirement of capital stock and participation certificates	(315,230)	(249,070)	(286,100)
Patronage distributions paid	(2,393,778)	(2,181,215)	(726,402)
Net cash provided by financing activities	20,554,408	21,794,458	21,579,256
Net (decrease) increase in cash	(1,125,058)	(96,703)	739,146
Cash at the beginning of the year	1,139,838	1,236,541	497,395
Cash at the end of the year	\$ 14,780	\$ 1,139,838	\$ 1,236,541

Supplemental schedule of noncash investing and financing activities:

Financed sales of other property owned	\$ -	\$ 188,700	\$ -
Loans transferred to other property owned	99,076	199,900	-
Loans charged off	-	4,816,248	-
Patronage distributions declared	2,745,000	2,398,622	-
Accumulated other comprehensive income	105,726	-	-
SFAS No. 158 accounting change	5,360	-	-

Supplemental cash information:

Cash paid during the year for interest	\$ 16,761,973	\$ 17,386,509	\$ 15,179,326
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The accompanying notes are an integral part of these consolidated financial statements.

**FLBA OF NORTH ALABAMA, FLCA
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 — ORGANIZATION AND OPERATIONS:

- A. Organization: FLBA of North Alabama, FLCA 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 Blount, Calhoun, Cherokee, Clay, Cleburne, Colbert, Cullman, DeKalb, Etowah, Fayette, Franklin, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Limestone, Madison, Marion, Marshall, Morgan, Randolph, Shelby, St. Clair, Talladega, Walker and Winston in the state of Alabama.

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, 6 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 secured long-term real estate mortgage loans, with funding from the Bank.

The Association also serves as an intermediary in offering credit life insurance to borrowers.

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 financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the 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' financial statements have been reclassified to conform to current financial statement presentation.

- 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.

Loans are carried at their principal amount outstanding adjusted for charge-offs and unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

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. 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 in the accompanying 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 the lower of the property's fair value less estimated selling costs upon acquisition or the related loan's carrying amount. 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 (Funds Held). To the extent that the borrower's access to such funds is restricted, the Funds Held 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 balance sheet. Funds Held are not insured. Interest is generally paid by the Association on such accounts at rates established by the board of directors. At December 31, 2008, the Association had no unrestricted Funds Held.
- 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. Also, the Association sponsors a nonqualified defined contribution 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 also participates in the Farm Credit Benefits Alliance 401(k) Plan which requires the Association 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.

In addition to the DB Plan, the DC Plan, and the Farm Credit Benefits Alliance 401(k) plans above, the Association sponsors a defined contribution supplemental retirement plan. This plan is a nonqualified 401(k) plan. No contributions have been made to the plan to date.

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. Employees hired prior to January 1, 2004 and who are at least 55 years of age (or at least age 50 with 30 years of service) may retire and have their medical premiums paid on a percentage of cost sharing basis predicated on length of employment service. Employees hired before this date that have reached the age requirement and have 25 years of service will receive 100 percent of their medical premiums paid. Employees hired after January 1, 2004 will be eligible for access only to retiree medical benefits for themselves, but will be responsible for 100 percent of the premium.

- I. Patronage Refunds From the Farm Credit Bank of Texas: The Association records patronage refunds from the Bank upon receipt of the patronage.
- J. Income Taxes: The Association is exempt from federal and other income taxes as provided under the Act.
- K. 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 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Assets held in trust funds relate to deferred compensation and our supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace. The Association did not hold any Level 1 assets or liabilities as of December 31, 2008.

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. The Association did not hold any Level 2 assets or liabilities as of December 31, 2008.

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.

- L. 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. There would be no impact to the Association's financial statement disclosures if adopted.

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

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	\$ 407,339,243	97.8%	\$ 379,136,114	97.7%	\$ 351,693,143	96.9%
Rural residential real estate	5,768,709	1.4%	5,109,022	1.3%	4,412,839	1.2%
Production and intermediate term	1,833,205	0.4%	2,034,656	0.5%	1,704,406	0.5%
Energy	1,575,066	0.4%	1,766,015	0.5%	1,882,476	0.5%
Agribusiness:						
Processing and marketing	-	0.0%	-	0.0%	368,602	0.1%
Communication	-	0.0%	-	0.0%	3,041,644	0.8%
Total	\$ 416,516,223	100.0%	\$ 388,045,807	100.0%	\$ 363,103,110	100.0%

Geographic Distribution:

County	2008	2007	2006
De Kalb	23.9%	24.2%	25.0%
Marshall	11.4%	11.4%	11.8%
Lawrence	6.0%	5.5%	4.9%
Jackson	5.2%	5.7%	5.7%
Blount	4.8%	4.9%	5.5%
Etowah	4.5%	4.7%	3.6%
Morgan	3.9%	3.9%	4.0%
Cullman	3.9%	3.4%	3.4%
Cherokee	3.4%	3.4%	3.1%
Limestone	3.3%	2.9%	2.8%
Madison	3.2%	3.1%	3.7%
Colbert	2.8%	2.7%	2.5%
Franklin	2.5%	2.1%	1.8%
Marion	2.4%	2.4%	1.2%
Lauderdale	2.1%	2.1%	2.3%
Talladega	1.6%	1.7%	1.7%
Walker	1.3%	1.4%	1.2%
Clay	1.2%	0.7%	0.4%
Shelby	1.0%	1.2%	1.3%
Cleburne	0.8%	1.0%	1.1%
Randolph	0.8%	0.8%	0.7%
St. Clair	0.7%	0.7%	0.9%
Other States	5.6%	6.3%	7.8%
Other	3.7%	3.8%	3.6%
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.

Portfolio Composition:

Operation/Commodity	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Poultry and eggs	\$ 203,410,199	48.8%	\$ 189,231,864	48.8%	\$ 171,513,406	47.2%
Livestock, except dairy and poultry	80,883,454	19.4%	77,229,055	19.9%	75,199,728	20.7%
Timber	48,640,736	11.7%	46,025,636	11.9%	43,851,323	12.1%
Field crops except cash grains	46,756,366	11.2%	41,951,595	10.8%	36,864,821	10.2%
Cash grains	9,897,083	2.4%	9,062,082	2.3%	9,134,101	2.5%
Chemical and allied products	7,564,667	1.8%	6,281,652	1.6%	2,803,537	0.8%
Rural home loans	5,882,441	1.4%	5,040,559	1.3%	3,705,928	1.0%
General farms, primarily crops	3,653,411	0.9%	4,130,113	1.1%	3,557,447	1.0%
Fruit and tree nuts	3,212,880	0.8%	3,295,371	0.8%	5,359,629	1.5%
Electric services	1,575,066	0.4%	1,766,015	0.5%	1,882,476	0.5%
Animal specialties	1,495,400	0.4%	621,553	0.2%	134,189	0.1%
Dairy farms	1,393,892	0.3%	1,619,744	0.4%	1,763,012	0.5%
Wholesale trade - nondurable goods	1,137,840	0.3%	1,191,899	0.3%	1,247,823	0.3%
Other	1,012,788	0.2%	598,669	0.1%	3,044,046	0.8%
Communications	-	0.0%	-	0.0%	3,041,644	0.8%
Total	\$ 416,516,223	100.0%	\$ 388,045,807	100.0%	\$ 363,103,110	100.0%

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.

One poultry integrator within the Association's territory has filed Chapter 11 bankruptcy restructuring during 2008. At this time, the Association has not seen any adverse effects to growers with Association loans as a result of this financial strain on the integrator. At December 31, 2008, Association loans to growers of this integrator consisted of 339 loans representing \$80.0 million in volume, of which \$29.2 million have government guarantees. The Association will continue to monitor developments within this specific sector of its loan portfolio and properly adjust loan values and any allowance for loan losses to appropriate levels as deemed needed.

Asset Quality:

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

	2008	2007	2006
Acceptable	95.0%	98.4%	97.4%
Special mention	3.8%	0.9%	2.1%
Substandard	1.2%	0.7%	0.5%
Doubtful	0.0%	0.0%	0.0%
Loss	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%

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	\$ 869,149	60.8%	\$ 40,038	1.7%	\$ 502,134	100.0%
Past due	561,078	39.2%	2,207,594	95.4%	-	0.0%
Total nonaccrual loans	<u>1,430,227</u>	<u>100.0%</u>	<u>2,247,632</u>	<u>97.1%</u>	<u>502,134</u>	<u>100.0%</u>
Accrual loans						
90 days or more past due	-	0.0%	67,347	2.9%	-	0.0%
Formally restructured	-	0.0%	-	0.0%	-	0.0%
Total impaired accrual loans	<u>-</u>	<u>0.0%</u>	<u>67,347</u>	<u>2.9%</u>	<u>-</u>	<u>0.0%</u>
Total impaired loans	<u>\$ 1,430,227</u>	<u>100.0%</u>	<u>\$ 2,314,979</u>	<u>100.0%</u>	<u>\$ 502,134</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	\$ 11,101	\$ 26,838	\$ 89,411
Interest income recognized on impaired accrual loans	9,491	1,342	2,672
Interest income recognized on impaired loans	<u>\$ 20,592</u>	<u>\$ 28,180</u>	<u>\$ 92,083</u>

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

	2008	2007	2006
Beginning balance	\$ 401,500	\$ 229,568	\$ 117,446
Provision for loan losses	107,745	4,988,180	112,122
Loans charged off	-	(4,816,248)	-
Recoveries	-	-	-
Allowance for loan losses	<u>\$ 509,245</u>	<u>\$ 401,500</u>	<u>\$ 229,568</u>

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

	2008	2007	2006
Impaired loans with related allowance	\$ 461,226	\$ 2,096,795	\$ 353,974
Impaired loans with no related allowance	969,001	218,184	148,160
Total impaired loans	<u>\$ 1,430,227</u>	<u>\$ 2,314,979</u>	<u>\$ 502,134</u>
Allowance on impaired loans	<u>\$ 279,022</u>	<u>\$ 283,022</u>	<u>\$ 18,592</u>

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

	2008	2007	2006
Average impaired loans	<u>\$ 2,149,217</u>	<u>\$ 1,201,219</u>	<u>\$ 615,960</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	\$ 728,630	\$ 858,043	\$ 114,522
Less: interest income recognized	(20,592)	(28,180)	(92,083)
Foregone interest income	<u>\$ 708,038</u>	<u>\$ 829,863</u>	<u>\$ 22,439</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	\$ 424,888	\$ 424,888	\$ 459,156
Building and improvements	1,293,328	1,294,608	1,260,339
Furniture and equipment	448,575	446,945	424,531
Computer equipment and software	114,383	123,107	108,284
Automobiles	480,506	448,467	391,808
Construction in progress	13,800	-	-
	<u>2,775,480</u>	<u>2,738,015</u>	<u>2,644,118</u>
Accumulated depreciation	(793,732)	(766,083)	(650,800)
Total	<u>\$ 1,981,748</u>	<u>\$ 1,971,932</u>	<u>\$ 1,993,318</u>

The Association leases office space in Moulton, Oneonta, and Talladega. Lease expense was \$15,530, \$12,675 and \$11,300 for 2008, 2007 and 2006, respectively. Minimum annual lease payments for the next five years are as follows:

	<u>Operating</u>
2009	\$ 11,165
2010	1,800
	<u>\$ 12,965</u>

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>
Gain on sale, net	\$ -	\$ 2,050	\$ -
Operating income (expense), net	5,249	(2,393)	-
Net gain (loss) on other property owned	<u>\$ 5,249</u>	<u>\$ (343)</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, was \$360,225,253 at 4.4 percent, \$337,026,991 at 5.4 percent and \$313,168,620 at 5.4 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 \$420,768,576, 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 and for the years ended December 31, 2008, 2007 and 2006, the Association was not subject to remedies associated with the covenants in the financing agreement.

NOTE 7 — MEMBERS' EQUITY:

Protection of certain borrower equity is provided under the Act that requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. If an association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

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 A capital stock (for farm loans), or participation certificates (for rural home and farm-related business loans) was equal to 2.0 percent of the loan amount, prior to 2004. In March 2004, on new loans only, the Association changed its stock investment requirement to the lesser of 2.0 percent of the loan amount, or \$1,000. In November 2005, the board of directors approved a stock reduction to equalize the stock of all borrowers to 2.0 percent or \$1,000, whichever is less.

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 10.0 percent of the loan amount.

Each owner of Class A capital stock 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 A to Class C stock. Class C 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 C shares is made solely at the discretion of the Association's board of directors. At December 31, 2008, 2007 and 2006, the Association had no Class C 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 holders of Class A capital 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 following patronage distributions were declared and paid in 2008, 2007 and 2006, respectively:

<u>Date Declared</u>	<u>Date Paid</u>	<u>Patronage</u>
January 2008	April 2008	\$ 2,393,778
January 2007	April 2007	2,181,215
January 2006	April 2006	726,402

The Association accrued a \$2,745,000 patronage payment to its stockholders based on its 2008 obligating patronage resolution that was declared by the board of directors in December 2008. This distribution will be paid in March 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 the FCA that, if undertaken, could have

a direct material effect on the Association's financial statements. The Association is 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 16.5 percent, 15.8 percent and 15.8 percent, respectively.

FCA regulations require that the Association's board of directors establish and maintain a formal written capital adequacy plan as a part of the required annual financial plan. The plan includes the capital targets that are necessary to achieve the Association's capital adequacy goals as well as the minimum permanent capital standards and surplus standards. This capital adequacy plan also addresses monitoring any projected dividends, patronage distribution, equity retirements, or other action that may affect the institution's permanent capital. The plan sets forth the circumstances in which retirements or revolvments of stock or equities may occur. In addition to factors that must be considered in meeting the minimum standards, the board of directors will also consider at least the following factors in developing the capital adequacy plan: capability of management and the board of directors; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risks, potential obligations under joint and several liability, contingent and off-balance sheet liabilities or other conditions warranting additional capital. At least quarterly, the Association's goals and objectives are reviewed with the board.

As described in Note 2, "Summary of Significant Accounting Policies," included in this annual report, 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. Currently, the required stock investment in the Bank is 2 percent of the average borrowings from the previous 12 months. This stock investment reduces the amount of Association capital available for inclusion in the Association's capital adequacy calculations.

An FCA regulation empowers the 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	473,752	457,921	434,387
Participation certificates	18,412	17,173	15,413
Total	<u>492,164</u>	<u>475,094</u>	<u>449,800</u>

NOTE 8 — CAPITAL MARKETS:

Until the second quarter of 2007, the Association participated in the Capital Markets of the South (CMS), a joint venture created in 2003 for the purpose of expanding the participants' lending opportunities. The CMS group was comprised of the Association, the Federal Land Bank Association of South Alabama, FLCA, the Land Bank of North Mississippi, FLCA, Southern Ag Credit, ACA (formerly Land Bank South, FLCA), and the Louisiana Federal Land Bank Association, FLCA. During the second quarter of 2007, the CMS members decided to discontinue and dissolve the joint venture. The associations will continue to service the existing CMS loan portfolio, with revenue and expenses continuing to be shared accordingly as noted below, until such time as all of the loans are fully matured or paid off.

Pursuant to the terms of the alliance, each of the five CMS participating associations generally shares equally in the costs of operating the venture. FLBA of North Alabama's pro rata share of income from CMS operations is recorded in the statement of income in their respective line items. The Association's pro rata share of expenses from CMS operations is recorded in the statement of income in the line item "Purchased Services."

As of December 31, 2008, 2007 and 2006, the Association had CMS-related loan volume outstanding in the amount of \$21,123,685, \$26,518,462 and \$27,111,370, respectively. In addition, the Association had unfunded commitments on CMS loans of \$8,258,695, \$17,351,763 and \$25,832,673 as of December 31, 2008, 2007 and 2006, respectively.

NOTE 9 — EMPLOYEE BENEFIT PLANS:

Employee Retirement Plans: As discussed in section G of Note 2, “Summary of Significant Accounting Policies,” employees of the Association participate in either the defined contributions plan (DC Plan) or the defined benefit retirement plan (DB Plan). The Association recognized pension costs for the DC Plan of \$57,688, \$45,374 and \$36,168 for the years ended December 31, 2008, 2007 and 2006, respectively. For the DB Plan, the Association recognized pension costs of \$669,572, \$199,505 and \$194,779 for the years ended December 31, 2008, 2007 and 2006, respectively.

Employees of the Association are also eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. The Association’s contributions to the 401(k) plan were \$86,314, \$73,055 and \$73,863 for the years ended December 31, 2008, 2007 and 2006, respectively.

The Association also sponsors a nonqualified defined contribution 401(k) plan. There have been no contributions to the plan to date.

Other Postretirement Benefits: 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. Employees hired prior to January 1, 2004 and who are at least 55 years of age (or at least age 50 with 30 years of service) may retire and have their medical premium paid on a percentage of cost sharing basis predicated on length of employment service. Employees hired before this date that have reach the age requirement and have 25 years of service will receive 100 percent of their medical premium paid. Employees hired after January 1, 2004 will be eligible for access only to retiree medical benefits for themselves, but will be responsible for 100 percent of the premium.

In September 2006, the FASB issued SFAS No. 158, “Pension and other Postretirement Benefits” (SFAS 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 \$5,360, and increased the other postretirement benefit liabilities by \$5,360.

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

Disclosure Information Under FASB Statement 132	2008	2007	2006
Change in Accumulated Postretirement Benefit Obligation			
Accumulated postretirement benefit obligation, beginning of year	\$ 917,073	\$ 951,271	\$ 1,002,937
Service cost	22,923	19,505	23,288
Interest cost	73,768	56,626	52,217
Plan participants' contributions	1,080	675	788
Plan amendments	-	-	(11,364)
Special termination benefits	-	-	-
Actuarial loss (gain)	35,835	(97,676)	(103,543)
Benefits paid	<u>(17,636)</u>	<u>(13,328)</u>	<u>(13,052)</u>
Accumulated postretirement benefit obligation, end of year	\$ 1,033,043	\$ 917,073	\$ 951,271
Change in Plan Assets			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Actual return on plan assets	-	-	-
Company contributions	16,556	12,653	12,264
Plan participants' contributions	1,080	675	788
Benefits paid	<u>(17,636)</u>	<u>(13,328)</u>	<u>(13,052)</u>
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ (1,033,043)	\$ (917,073)	\$ (951,271)
Amounts Recognized in Statement of Financial Position			
Noncurrent assets	\$ -	\$ -	\$ -
Current liabilities	(19,611)	(18,335)	(16,686)
Noncurrent liabilities	<u>(1,013,432)</u>	<u>(895,722)</u>	<u>(934,585)</u>
Total	\$ (1,033,043)	\$ (914,057)	\$ (951,271)
Amounts Recognized in Accumulated Other Comprehensive Income			
Net actuarial loss (gain)	\$ 118,930	\$ 83,929	\$ -
Prior service cost (credit)	(392,799)	(463,523)	-
Net transition obligation (asset)	<u>-</u>	<u>-</u>	<u>-</u>
Total	\$ (273,869)	\$ (379,594)	\$ -
Additional Information			
Increase in minimum liability included in other comprehensive income	\$ 105,726	\$ -	\$ -
Weighted-Average Assumptions Used to Determine Obligations at Year-end			
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	\$ 18,338	\$ 19,505	\$ 23,288
Interest cost	59,014	56,626	52,217
Expected return on plan assets	-	-	-
Amortization of:			
Unrecognized net transition obligation (asset)	-	-	-
Unrecognized prior service cost	(56,580)	(60,895)	(60,190)
Unrecognized net loss (gain)	668	1,969	10,896
Net postretirement benefit cost	21,440	17,205	26,211
Adjustment to retained earnings for 2008 due to change in measurement date	\$ 5,360	N/A	N/A

Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income

Net actuarial loss (gain)	\$ 35,835	\$ -	\$ -
Amortization of net actuarial loss (gain)	(835)	-	-
FAS88 recognition of loss (gain)	-	-	-
Prior service cost (credit)	-	-	-
Amortization of prior service cost	70,726	-	-
FAS88 recognition of prior service cost	-	-	-
Amortization of transition liability (asset)	-	-	-
Total recognized in other comprehensive income	\$ 105,726	\$ -	\$ -

AOCI Amounts Expected to be Amortized into Expense in 2009

Unrecognized net transition obligation (asset)	\$ -	\$ -	\$ -
Unrecognized prior service cost	(55,868)	(56,580)	-
Unrecognized net loss (gain)	1,355	668	-
Total	\$ (54,513)	\$ (55,912)	\$ -

Weighted-Average Assumptions Used to Determine Benefit Cost

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%	9.0%/6.75%	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

Expected Future Cash Flows

Expected Benefit Payments (net of employee contributions)

Fiscal 2009	\$ 19,611
Fiscal 2010	28,314
Fiscal 2011	39,251
Fiscal 2012	51,915
Fiscal 2013	57,573
Fiscal 2014–2018	362,556

Expected Contributions

Fiscal 2009	\$ 19,661
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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 \$4,488,794, \$4,794,040 and \$4,278,097 at December 31, 2008, 2007 and 2006, respectively. During 2008, \$116,000 of new loans were made and repayments totaled \$421,246. 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 \$841,221, \$785,238 and \$760,610 in 2008, 2007 and 2006, respectively.

The Association received patronage payments from the Bank totaling \$1,369,608, \$1,307,584 and \$1,181,801 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. During 2008, the Association was party to three lawsuits related to a large participation loan (the "Loan"). The Loan was originated by FLBA of South Alabama, FLCA to one borrower through Capital Markets of South (CMS) and participated to 13 other Farm Credit associations. The two lawsuits were initiated by the FLBA of South Alabama in its capacity as the named lead lender. The original funded balance of the Loan was \$68,500,000, and FLBA of North Alabama retained 5.56 percent of the Loan. During 2007 the Loan, which is significantly undercollateralized, was declared to be in default and transferred to nonaccrual status, and collection actions were commenced. Also during 2007, the Association along with the other CMS member associations repurchased and purchased, as appropriate, on a pro rata basis the portions of the Loan held by all other non-CMS participants. As part of the Loan repurchase and purchase transactions noted above, the Association received a general release from the non-CMS participants for claims related to the Loan; however, the non-CMS participants continue to potentially, under certain circumstances, share in certain collections from the borrower. FLBA of North Alabama, along with the other four associations that comprised CMS, have agreed to indemnify and hold harmless the non-CMS participants from any liability arising from legal proceedings related to the Loan.

The initial lawsuit brought in Texas state court, the domicile state of the borrower, was commenced for the purpose of obtaining access to collateral for the loan. This suit was successful and was dismissed during 2008.

The overall character of the two remaining lawsuits is of collection of the principal and interest from the borrower, control of the loan's remaining collateral, an effort to recover property purchased with the Loan proceeds and assertion of claims against parties related to the borrower. One of the lawsuits was filed in the borrower's domicile state of Texas in U.S. federal district court and involved civil complaints against the borrower and other related individuals as well as third parties for damages incurred as a consequence of alleged wrongful acts by the respective parties and an effort to recover assets acquired with proceeds of the Loan from such parties. This suit for the civil action brought by FLBA of South Alabama in Texas federal court started in early February. The borrower and all related defendants in this action have agreed to an injunction precluding the transfer of any assets acquired with proceeds of the Loan. The other lawsuit was filed in the state of Kentucky, where the primary real estate collateral is located, for the purpose of gaining access to and foreclosing the lien of its mortgages on the real estate and commencing an action for collection of the debt. The Kentucky state court has appointed a receiver to protect the collateral and preserve the status quo pending resolution of the suit. The borrower and other related individuals have responded in both of the described actions by filing a counterclaim seeking damages against FLBA of South Alabama and the other four CMS member associations, alleging various claims, including breach of contract.

These legal proceedings have been lengthy and the outcome as to some of the counterclaims is unknown as of year end. However, on December 12, 2008, at the request of FLBA of South Alabama, the judge in the Texas federal case dismissed all counterclaims except those of two individuals. Similarly, the Kentucky court dismissed all counterclaims pending in that suit in late December effectively ending all litigation pending in Kentucky except that brought by the FLBA of South Alabama to foreclose the lien of its mortgage in Muhlenberg County. In addition, the Kentucky court had previously granted summary judgment in favor of FLBA of

South Alabama for the debt plus interest, costs and fees. This judgment on the debt dispensed with a major portion of FLBA of South Alabama's action in Kentucky and allowed FLBA of South Alabama to realize on its real estate collateral through foreclosure sales. After receiving this judgment, FLBA of South Alabama pursued collection of the same in Texas state court, against property of the borrower, and has been successful in having certain real and personal properties turned over for the purpose of selling the same. These properties have not been sold as of December 31, 2008, but that is anticipated to occur in the near future.

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, \$12,447,978 of unfunded credit commitments and no commercial letters of credit 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. At December 31, 2008, the Association had approximately \$990,538 in outstanding standby letters of credit, issued primarily in conjunction with participation loans. The fair value of these obligations at December 31, 2008 is based on the fees for the unexpired period remaining, which are negligible.

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	\$ 14,780	\$ 14,780	\$ 1,139,838	\$ 1,139,838	\$ 1,236,541	\$ 1,236,541
Loans, net	416,006,978	436,982,050	387,644,307	388,908,027	362,873,542	358,573,491
Financial liabilities						
Note payable to the Bank	360,225,253	378,387,810	337,026,991	338,125,699	313,168,620	309,457,572

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 in the accompanying balance sheet. The Association owns 3.1 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	\$ 2,837	\$ 2,852	\$ 2,919	\$ 3,027	\$ 11,635
Reversal of (Provision for) loan losses	4	(12)	(19)	(81)	(108)
Noninterest expense, net	(932)	(1,074)	(1,131)	(485)	(3,622)
Net income	<u>\$ 1,909</u>	<u>\$ 1,766</u>	<u>\$ 1,769</u>	<u>\$ 2,461</u>	<u>\$ 7,905</u>
	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,851	\$ 2,696	\$ 2,836	\$ 2,835	\$ 11,218
Provision for loan losses	(12)	(1,638)	(690)	(2,648)	(4,988)
Noninterest expense, net	(758)	(893)	(960)	(267)	(2,878)
Net income	<u>\$ 2,081</u>	<u>\$ 165</u>	<u>\$ 1,186</u>	<u>\$ (80)</u>	<u>\$ 3,352</u>
	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,592	\$ 2,593	\$ 2,684	\$ 2,782	\$ 10,651
Reversal of (Provision for) loan losses	12	1	(5)	(120)	(112)
Noninterest expense, net	(806)	(735)	(666)	(260)	(2,467)
Net income	<u>\$ 1,798</u>	<u>\$ 1,859</u>	<u>\$ 2,013</u>	<u>\$ 2,402</u>	<u>\$ 8,072</u>

NOTE 14 – SUBSEQUENT EVENTS:

In connection with the legal proceedings described in Note 11, "Commitments and Contingencies," above, several relevant events have occurred in early 2009. First, in January, all remaining counterclaims against FLBA of South Alabama and the other CMS associations were dismissed in Texas federal court. Second, in early February, the trial for the civil action brought by FLBA of South Alabama in Texas federal court was held and the judge's final determination is unknown at this time. Third, on February 9, 2009, FLBA of South Alabama received court approval to foreclose the lien of its mortgage on real estate held as collateral in Muhlenberg County, Kentucky. Intentions are to hold a foreclosure sale for the property in late March or early April 2009. Fourth and finally, on February 16, 2009, FLBA of South Alabama received court approval to sell certain real and personal properties that were purchased with proceeds from the loan. Sale of these properties is expected in the near future.

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 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 FLBA of North Alabama, FLCA (Association) serves its 27-county territory through its main administrative and lending office at 1949 St. Joseph Drive NW, Cullman, Alabama 35055. Additionally, there are five branch lending offices located throughout the territory. The Association owns the office buildings in Albertville, Athens, Cullman and Tusculumbia, free of debt. The Association leases the office building in Talladega and outposts in Moulton and Oneonta. The Association is in the process of purchasing a lot to build an office building for its Talladega Branch.

LEGAL PROCEEDINGS

In the ordinary course of business, the Association is involved in various legal proceedings. The information required to be disclosed in this section is incorporated herein by reference from Note 11 to the financial statements, "Commitments and Contingencies," included in this annual report. Also see the "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report for more information.

DESCRIPTION OF CAPITAL STRUCTURE

The information required to be disclosed in this section is incorporated herein by reference from Note 7 to the 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 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 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 fcb@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 FLBA of North Alabama, FLCA, P.O. Box 639, Cullman, Alabama 35056 or calling (256) 737-7128. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing karri.sumrall@farmcreditbank.com. The Association's annual stockholder report is available on its web site at www.alabamalandbank.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:

NAME	POSITION	DATE ELECTED/ EMPLOYED	TERM EXPIRES
Lloyd Rutherford	Chairman	1990	2010
Larry Don McGee	Vice Chairman	1997	2009
John Walton Anderson	Member	1998	2010
Matthew J. Christjohn, DVM	Member	2005	2011
Jimmy Wayne Harvey	Member	2006	2009
Benny Neal Smith	Member	1996	2011
John R. Adams, CPA	Director-Elected Director	2006	2009
H. Dennis Haynes, DVM	Director Elected Director	1998	2009
David A. Howse	President/Chief Executive Officer	1989	-
J. Farol Little	Chief Credit Officer/Sr. Vice President	1989	-
Karri H. Sumrall, CPA	Chief Financial Officer/ Sr. Vice President	2003	-
K. Ben Gore	Sr. Vice President/Branch Operations	1989	-

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

Lloyd Rutherford, age 67. Mr. Rutherford is semi-retired living in Lawrence County. He and his wife Janice are active members of the Moulton Church of Christ. Before retiring he worked for 32 years with a local cooperative along with raising cotton, soybeans, cattle and broilers. He has served as chairman of the board since 1995. He serves on the Stockholders Advisory Committee, Tenth District Benefits Administrative Committee and the Texas/AgFirst Benefit Alliance Plan Sponsor Committee for the Farm Credit Bank of Texas. He also serves on the Tenth District Farm Credit Council Board, the National Farm Credit Council Board and the FCC Services Board. He owns and operates JRL Inc., a construction and development Company in Moulton, Alabama.

Larry Don McGee, age 59. Mr. McGee is a full-time poultry and cattle farmer from Jackson County. He owns and operates 500 acres in Jackson and DeKalb counties. He has approximately 200 head of brood cows along with 3 pullet houses with a capacity of 21,000 and 2 breeder hen houses with a capacity of 21,000. He has been the owner/operator of L & D Farms for the past 24 years. He is a director for the San Mountain-Lake Guntersville Water Shed, a member of DeKalb County Cattlemen’s Association, Alabama Poultry & Egg Association and the National Federation of Independent Business. Mr. McGee serves as the chairman on the Association’s Audit Committee. The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities relating to the quality of financial reporting, the system of internal control, the audit process, and the Association’s process for monitoring compliance with laws and regulations and the code of conduct.

John Walton Anderson, age 63. Mr. Anderson is a full-time row crop and cattle farmer in Limestone County. He has been farming for the past 39 years and his operation consists of approximately 4,000 acres of cropland, pasture and timber. His current operation includes some 2,000 acres of row crops and 400 head of brood cows. He is a member of the Limestone County and Alabama Cattlemen’s Association. Mr. Anderson is also a member of the Association’s Human Resource Committee. The primary function of the Human Resource Committee is to provide assistance to the Board of Directors in fulfilling the Board’s responsibilities on matters relating to compensating the Board and the Association’s CEO; reviewing the compensation policies and plans for senior officers and employees, including incentive compensation plans and benefits; overseeing the Association’s management succession planning; and engaging in such other matters as may from time to time be specifically delegated to the Committee by the Board.

Matthew J. Christjohn, DVM, age 38. Dr. Christjohn is the owner and operator of Large Animal Veterinary Services, a practice concentrating on farm animals – mainly cattle and horses. The business covers territory in Alabama, Georgia, and Florida. Dr. Christjohn received his animal and dairy science degree from Auburn in 1992, doctor of veterinary medicine degree from Auburn in 1995 and master of business administration from University of Phoenix in January 2008. In addition to his business, he presently owns and operates a 220-acre cattle farm in Wedowee, AL. Dr. Christjohn is a member of the American and Alabama Veterinary Medical Associations, Society for Theriogenology, American Association of Bovine Practitioners, Academy of Veterinary Consultants, American Association of Veterinary Nutrition, National Cattleman's Beef Association, Alabama Cattlemen's Association and the Florida Cattlemen's Association. Dr. Christjohn is also a member of the Association's Audit Committee. The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities relating to the quality of financial reporting, the system of internal control, the audit process, and the Association's process for monitoring compliance with laws and regulations and the code of conduct.

Jimmy Wayne Harvey, age 57. Mr. Harvey is a licensed Alabama home builder. He retired from the construction business in 2000 after 18 years. He owns and operates a 91.5-acre cattle and poultry farm, in Marshall County, having a farm capacity of 190,000 broilers. He has been in the poultry business for 18 years and is a member of the Alabama Poultry and Egg Association and Marshall Farmers Co-op.

Benny Neal Smith, age 70. Mr. Smith is retired from Synergy Gas Company after 33 years as a route salesman. He operates an approximately 100-acre cattle and poultry farm in Etowah County. He has approximately 50 brood cows along with a broiler contract from Koch Poultry Company having a farm capacity of 110,000 broilers. He has been in the poultry business for the past 44 years. He is a member of the Alabama Poultry and Egg Association and the Alabama Cattlemen's Association. Mr. Smith is also a member of the Association's Human Resource Committee. The primary function of the Human Resource Committee is to provide assistance to the Board of Directors in fulfilling the Board's responsibilities on matters relating to compensating the Board and the Association's CEO; reviewing the compensation policies and plans for senior officers and employees, including incentive compensation plans and benefits; overseeing the Association's management succession planning; and engaging in such other matters as may from time to time be specifically delegated to the Committee by the Board.

John R. Adams, CPA, age 48. Mr. Adams is a certified public accountant with over 26 years' experience in public accounting. He is a partner in a local accounting firm in Decatur, Alabama. Mr. Adams received his bachelor of science degree with an emphasis in accounting from the University of Alabama. He is a member of the American Institute of Certified Public Accountants, Alabama Society of Certified Public Accountants and National Society of Accountants for Cooperatives. Mr. Adams is also a member of the Association's Audit Committee. The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities relating to the quality of financial reporting, the system of internal control, the audit process, and the Association's process for monitoring compliance with laws and regulations and the code of conduct.

H. Dennis Haynes, DVM, age 57. Dr. Haynes is the owner of Compton's Veterinary Hospital in Cullman, Alabama. He has practiced veterinary medicine for over 34 years on small and large animals. Dennis received his doctorate of veterinary medicine degree from Auburn University. He presently owns and operates a part-time farm, producing cattle and hay. He is a member of Alabama Veterinary Medicine Association and a member of Alabama Cattlemen's Association. Mr. Haynes is also the chairman of the Association's Human Resource Committee. The primary function of the Human Resource Committee is to provide assistance to the Board of Directors in fulfilling the Board's responsibilities on matters relating to compensating the Board and the Association's CEO; reviewing the compensation policies and plans for senior officers and employees, including incentive compensation plans and benefits, overseeing the Association's management succession planning; and engaging in such other matters as may from time to time be specifically delegated to the Committee by the Board.

David A. Howse, age 59. Mr. Howse was employed by the Association as chief executive officer in 1989. He has a total of 36 years' experience with the Farm Credit System. Mr. Howse announced his retirement during 2008. Effective January 2, 2009, Mr. Howse was appointed to the role as advisor to the board until his official retirement date of February 20, 2009.

J. Farol Little, age 61. Mr. Little was employed by the Association in 1989. He has a total of 37 years' experience with the Farm Credit System.

Karri H. Sumrall, CPA, age 37. Ms. Sumrall is a certified public accountant with over 8 years of experience in public accounting with an emphasis in financial institutions and has 5 years' experience with the Farm Credit System.

K. Ben Gore, age 56. Mr. Gore has a total of 32 years' experience with the Farm Credit System. Mr. Gore was selected to replace Mr. Howse as CEO effective January 2, 2009.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors were compensated for their service to the Association in the form of a monthly retainer of \$750 per month and \$500 per day for regular, special and committee meetings. For meetings in which they served on other Farm Credit boards (for which they are compensated), and also represent the Association, the Association pays any difference in meeting honorarium paid to the director, up to the \$500 per day. Directors 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 for the first half of 2008 and 58.5 cents per mile for the second half of 2008. A copy of the travel policy is available to stockholders of the Association upon request.

Director	Number of Days Served Associated With			2008 Compensation Paid for Other Farm Credit Meetings	Total Compensation in 2008
	Board Meetings	Other Official Committee Activities	# Days Board and Committee Meetings Held on Same Day*		
Loyd Rutherford	12	26	-	\$ 1,800	\$ 29,800
Larry Don McGee	12	17	2	-	22,500
John Walton Anderson	11	14	1	-	21,000
Matthew J. Christjohn, DVM	12	17	2	-	22,500
Jimmy Wayne Harvey	12	13	-	-	21,500
Benny Neal Smith	12	11	1	-	20,000
John R. Adams, CPA	12	20	2	-	24,000
H. Dennis Haynes, DVM	12	12	1	-	20,500
				\$ 1,800	\$ 181,800

*No additional honorarium paid when Board and Committee meetings held on same day.

The aggregate compensation paid to directors in 2008, 2007 and 2006 was \$181,800, \$168,300 and \$86,300, respectively. Additional detail regarding director compensation paid for Committee service (which is included in the table above) is as follows:

Director	Committee		
	Audit*	Human Resource*	Steering
Loyd Rutherford	\$ -	\$ -	\$ 1,500
Larry Don McGee	2,500	-	-
John Walton Anderson	-	1,000	1,500
Matthew J. Christjohn, DVM	2,500	-	-
Benny Neal Smith	-	1,000	-
John R. Adams, CPA	2,500	-	1,500
H. Dennis Haynes, DVM	-	1,000	-
	\$ 7,500	\$ 3,000	\$ 4,500

*Two Audit Committee meetings and one Human Resource Committee meeting were held on the same day as Board meetings; only the \$500 per day honorarium was received for attending both the Committee meeting and Board meeting.

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$46,898, \$52,686 and \$47,464 in 2008, 2007 and 2006, respectively.

Name of Individual or Group	Year	Salary	Incentive	Deferred/Perquisite	Other	Total	
David A. Howse President/CEO	2008	\$ 190,500	\$ 19,241	\$ 4,301	\$ 1,719	\$ 215,761	
	2007	164,500	15,463	3,958	1,452	185,373	
	2006	155,000	22,475	4,685	7,308	189,468	
Total highest paid officers, excluding CEO	(5)	2008	510,400	57,046	24,371	18,191	610,008
	(5)	2007	491,268	58,806	20,716	18,245	589,035
	(5)	2006	460,340	77,929	16,620	16,415	571,304

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.

The Association provides certain employees use of Association automobiles. The employee's personal use of these automobiles is governed by the Association's board-approved travel and vehicle policy as well as IRS rules. Employees assigned a vehicle are required to maintain a business mileage log. Personal use of these vehicles is calculated and reported in compliance with current IRS regulations. Amounts for personal use of an Association vehicle are included in "Perquisite" in the above table.

Employees who use their personal automobile for business purposes were reimbursed during 2008 at the IRS-approved rate of 50.5 cents per mile for the first half of 2008 and 58.5 cents per mile for the second half of 2008.

Association employees, including senior officers, can earn compensation above base salary through an annual success-sharing incentive plan. The plan is based upon the achievement of predetermined Association performance goals and is approved by the board of directors annually. All full time employees that have been employed at least six months are eligible to earn an individual incentive up to 25 percent of their annual salary based upon their individual performance objectives. Also included in the incentive plan is the opportunity to earn commissions. The Association participates in a program with an outside insurance entity to provide borrowers the opportunity to purchase credit life insurance. Association employees receive commissions from the outside insurance entity through the Association.

The Association also participates in a program with AgSouth Farm Credit, ACA to provide borrowers with secondary housing loans. Association employees receive commissions based on the fee income received by the Association for loans closed under this program. Also, employees are eligible to receive commissions on leases originated through Farm Credit Leasing. Amounts paid under these plans are included in "Incentive" in the table above.

The Association also provides group term life insurance to all employees in an amount equal to double the employees' respective salaries. To the extent that the value of this life insurance exceeds \$50,000, an amount is added to each respective employee's taxable earnings using the IRS-approved calculation. Amounts relating to excess life insurance are included in "Other" in the table above.

Association policy allows a maximum of 240 hours of annual leave to be carried over from one fiscal year to the next. Employees with more than 240 hours of annual leave time may "cash out" up to 80 hours of annual leave, with any remaining hours in excess of the 240-hour limit being converted to sick leave time. Amounts relating to cashing out excess annual leave time are included in "Other" in the table above.

The Association's travel policy allows spousal travel in some instances. Travel expenses reimbursed for spousal travel are considered to be paid to the employee or director under a nonaccountable plan and are therefore included in their gross income or IRS Form 1099 in accordance with IRS guidelines. Amounts relating to reimbursed travel expenses are included in "Perquisite" in the table above.

The Association sponsors a defined contribution supplemental retirement plan eligible to employees whose compensation exceeds the IRS threshold of \$105,000 in the preceding year. This plan would allow for an employee to restore their contributions restricted by IRS limits to salary, elective deferrals made by employees to defer compensation out to a future date, discretionary contributions made by the Association to a select group of employees and retention feature using vesting schedules for discretionary contributions. This plan is a nonqualified 401(k) plan. No contributions have been made to the plan to date.

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 financial statements, "Related Party Transactions," included in this annual report.

DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

During the past five years, none of the Association's officers or directors has been involved in legal proceedings that are material to an evaluation of the ability or integrity of any person who served as director or senior officer.

RELATIONSHIP WITH INDEPENDENT AUDITOR

No change in auditors has taken place since the last annual report to stockholders and no disagreements with auditors has occurred that the Association is required to report to the Farm Credit Administration under part 621 of the FCA regulations governing this disclosure. Fees paid during the reporting period for audit services to the independent auditors for audit services were \$33,416. No other services were rendered by the independent auditors during the reporting period.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 4, 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 is committed to meeting the needs of Young, Beginning and Small (YBS) farmers and ranchers and recognizes the need to support these operators to ensure a strong agricultural community for the future. Support of YBS lending activities is a priority in the Association. Additional employee time and other resources are combined with the most liberal application of the Association’s underwriting standards possible to meet the credit needs of YBS farmers and ranchers. In addition, the Association actively supports other programs, events, scholarships and educational activities that benefit young people who will become the agricultural providers of tomorrow.

The Association sets minimum standards and monitors its YBS performance on a regular basis. These results are also compared to the demographics of the territory it serves as reflected in the USDA Census of Agriculture (Census).

Definitions for “young,” “beginning” and “small” farmers and ranchers used by the Association are:

- Young: Age 35 or younger as of the loan date
- Beginning: 10 years or less of farming, ranching or aquatic experience as of the loan date
- Small: Less than \$250,000 in annual gross sales of agricultural products

Slight differences noted between the Census and our YBS information is as follows:

- The Census shows young farmers in a group up to age 34, whereas the Association’s YBS information shows young farmers up to age 35.
- The Census shows years on present farm a class up to 9 years, whereas the Association’s YBS information shows 10 years or less for a beginning farmer.
- The Census data is based on number of farms, whereas the Association’s YBS information is based on number of loans.

The 2002 USDA Census of Agriculture for Alabama indicates that 5.20% of farm operators are “young,” 29.60% are “beginning” and 91.30% of the farms are “small.” The Association’s minimum standards for YBS lending require the following:

YBS Class	Percentage of Total Loans	Percentage of Loan Volume
Young	>10%	>10%
Beginning	>25%	>25%
Small	>40%	>40%

The Association’s YBS loans, as a percentage of total loans outstanding as of December 31, are reflected in the table below for the past three years:

	2006		2007		2008	
	% of Total Loans	% of Loan Volume	% of Total Loans	% of Loan Volume	% of Total Loans	% of Loan Volume
Young	26.84%	27.09%	27.10%	28.93%	26.48%	29.41%
Beginning	49.23%	46.95%	48.85%	48.75%	49.16%	50.25%
Small	79.31%	71.51%	78.47%	73.93%	79.07%	74.19%

The Association's YBS loans, as a percentage of all loans closed each year, are reflected in the table below for the past three years:

	2006		2007		2008	
	% of New Loans	% of New Loan Volume	% of New Loans	% of New Loan Volume	% of New Loans	% of New Loan Volume
Young	25.39%	25.39%	26.08%	30.38%	23.40%	28.00%
Beginning	46.06%	46.06%	46.41%	48.74%	50.64%	55.17%
Small	76.40%	76.40%	72.48%	71.22%	77.66%	73.64%

For purposes of the above tables, a loan could be classified in more than one category depending upon the characteristics of the underlying borrower. The number and volume of loans in many cases falls into more than one category. For example, a 32-year-old farmer with farm income of \$150,000 would be counted in the statistics for both "young" and "small" categories.

The Association continues to provide credit to YBS farmers and ranchers at high levels as reflected by the above comparative data. Emphasis on this area of the Association's lending business will continue to be a priority.

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