

2009 Quarterly Report



For the 3rd Quarter Ended September 30, 2009

REPORT OF MANAGEMENT

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



Charles P. Gant
Chief Executive Officer/President
November 6, 2009



Barnett L. Baker
Chairman, Board of Directors
November 6, 2009



Sharla Chambers
Chief Financial Officer
November 6, 2009

Management's Discussion and Analysis

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

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's Audit Committee.

RESULTS OF OPERATIONS:

Net Income

The Association had net income of \$1,612,216 and \$4,041,164 for the three and nine months ended September 30, 2009, as compared to net income of \$2,029,388 and \$6,218,284 for the same periods in 2008 reflecting a decrease of 20.6 and 35.0 percent, respectively. The decrease in net income for the three months ended September 30, 2009, consisted of a \$63,518 decrease in net interest income, a \$10,074 decrease in noninterest income, an \$89,987 increase in noninterest expenses, and a \$253,593 increase in provision for loan losses expense as compared to the same period in 2008.

Net Interest Income

Net interest income was \$2,972,255 and \$8,975,349, respectively, for the three and nine months ended September 30, 2009, compared to \$3,035,773 and \$9,017,653 for the same periods in 2008. An increased average loan volume for the third quarter of 2009 in the amount of \$423,404,965, compared to \$410,997,566 in the third quarter of 2008 was slightly offset by a decrease in the average spread on the loan portfolio of 2.14 percent in the third quarter of 2009, compared to 2.16 percent in the third quarter of 2008. In addition, the loan portfolio experienced an increased level of nonaccrual loans in 2009 which negatively impacted interest income, and ultimately net interest income for the quarter and nine months ended September 30, 2009.

Noninterest Income and Expense

Noninterest income for the quarter ended September 30, 2009, decreased by \$10,074 or 3.17 percent from the same period in 2008. This decrease was due primarily to a decline in loan fees collected on loans serviced and originated by the Association in the third quarter of 2009 as compared to a higher than average volume of loan fees collected during the same period in 2008. Noninterest expenses for the quarter ended September 30, 2009, increased by \$89,987 or 7.06 percent from the same period in 2008. The increase is primarily attributable to an increase in Farm Credit System Insurance Corporation (FCSIC) expenses as well as increased salary and benefits expenses related to pension plan costs.

Provision for Loan Losses

Provision for loan losses for the three and nine months ended September 30, 2009, was \$303,593 and \$1,965,507, representing an increase of \$253,593 and \$1,815,507 as compared to the same periods in 2008. During the third quarter of 2009, the Association recorded specific provisions totaling \$253,593 on participation loans to two borrowers which were placed into nonaccrual status during the quarter. Following this, the allowance at September 30, 2009, was considered adequate by management to absorb probable losses inherent in its portfolio.

Financial Ratios

The Association's return on average assets for the nine months ended September 30, 2009, was 1.26 and 2.01 percent for the same period in 2008. The Association's return on average equity for the nine months ended September 30, 2009, was 6.58 and 10.54 percent for the same period in 2008. These decreases are caused by lower net income in 2009 which is largely related to a decrease in earnings on own funds caused by lower interest rates, slightly higher operating costs, and additional provision for loan loss expenses as discussed above.

LOAN PORTFOLIO:

Total loans outstanding at September 30, 2009, including nonaccrual loans and sales contracts, were \$428,206,375 compared to \$408,270,608 at December 31, 2008, reflecting an increase of 4.9 percent that was attributable largely to growth in the Production Credit Association (PCA) subsidiary.

Nonaccrual loans as a percentage of total loans outstanding were 2.1 percent at September 30, 2009, compared to 1.0 percent at December 31, 2008. The Association recorded no recoveries or charge-offs for the quarter ending September 30, 2009, and no recoveries or charge-offs for the same period in 2008. The Association's allowance for loan losses was 0.5 percent and 0.1 percent of total loans outstanding as of September 30, 2009, and December 31, 2008, respectively.

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

| | September 30, 2009 | | December 31, 2008 | |
|---|---------------------|---------------|---------------------|---------------|
| | Amount | % | Amount | % |
| Nonaccrual | \$ 8,931,438 | 99.9% | \$ 4,210,523 | 100.0% |
| 90 days past due and still accruing interest | 8,714 | 0.1% | - | 0.0% |
| Total | <u>\$ 8,940,152</u> | <u>100.0%</u> | <u>\$ 4,210,523</u> | <u>100.0%</u> |

As of September 30, 2009, the Association's portfolio included nonaccrual loans in the amount of \$8,931,438, which represented a 112.3 percent increase from December 31, 2008. The increase is due in large part to the reclassification of four participation loans for which it was deemed probable that not all principal and interest would be collected according to contractual terms.

With the exception of a small number of large participation loans, the overall quality of the portfolio remained strong through the third quarter of 2009, with loans classified under Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" at 97.66 percent of total loans and accrued interest at September 30, 2009.

Cattle prices have been fairly stable with improving pasture conditions and a reduction in feed costs through lower grain prices. However, while export sales are still weak, ongoing demand for meat protein and supply management in meat production have continued to provide support for meat prices. As the United States continues to seek expansion of export sales, markets will likely find ongoing support internationally, depending on the state of the international economy, particularly those in emerging markets, going forward.

Summer rainfall levels were inadequate and left some portions of the Central Texas market serviced by the Association without enough rainfall during critical points of the growing season. Fuel and fertilizer costs, which are impacted by changes in fuel oil and natural gas prices, continue to be a major consideration in producers' planning processes. While fuel oil and natural gas prices have decreased in the previous year, market volatility could continue to put upward pressure on these prices. Cotton and grain prices have also come under pressure due to weaker export markets and USDA crop reports, and prices in the commodity markets in general have experienced a trend of decline during the overall softening in the financial markets.

LIQUIDITY AND FUNDING SOURCES:

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

| | September 30, | December 31, |
|----------------------------------|-----------------------|-----------------------|
| | 2009 | 2008 |
| Note payable to the Bank | \$ 353,020,385 | \$ 333,802,614 |
| Accrued interest on note payable | 1,087,139 | 1,293,137 |
| Total | <u>\$ 354,107,524</u> | <u>\$ 335,095,751</u> |

The Association experienced a \$19,011,773 increase in notes and accrued interest payable to the Bank through the quarter ended September 30, 2009, due to increased loan volume experienced by the Association since December 31, 2008.

CAPITAL RESOURCES:

The Association's capital position increased by \$3,984,147 at September 30, 2009, compared to December 31, 2008. The Association's debt as a percentage of members' equity was 425.6:1 as of September 30, 2009, compared to 426.8:1 as of December 31, 2008.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at September 30, 2009, was 17.6 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at September 30, 2009, were 17.0 and 17.0 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS:

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

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

The Association's quarterly stockholder reports are also available free of charge, upon request 45 days after the close of the quarter. These reports can be obtained by writing to Texas Land Bank, ACA, P.O. Box 20997, Waco, Texas 76702 or calling (254) 772-6905. Copies of the Association's quarterly and annual stockholder reports can also be requested by e-mailing sharla.chambers@texaslandbank.com.

TEXAS LAND BANK, ACA

Consolidated Balance Sheet

| | September 30, 2009 (unaudited) | December 31, 2008 |
|---|--------------------------------------|-----------------------|
| ASSETS | | |
| Cash | \$ 740,280 | \$ 60,000 |
| Loans | 428,206,375 | 408,270,608 |
| Less: allowance for loan losses | 2,342,829 | 368,663 |
| Net loans | 425,863,546 | 407,901,945 |
| Accrued interest receivable | 4,923,779 | 3,928,186 |
| Investment in and receivable from the Bank: | | |
| Capital stock | 6,605,955 | 6,605,955 |
| Other | - | 380 |
| Premises and equipment | 1,434,117 | 1,364,663 |
| Other assets | 359,878 | 118,987 |
| Total assets | \$ 439,927,555 | \$ 419,980,116 |
| LIABILITIES | | |
| Note payable to the Bank | \$ 353,020,385 | \$ 333,802,614 |
| Advance conditional payments | - | 305 |
| Accrued interest payable | 1,087,881 | 1,293,137 |
| Drafts outstanding | 406,978 | 666,896 |
| Patronage distributions payable | - | 2,751,042 |
| Other liabilities | 1,713,667 | 1,751,624 |
| Total liabilities | 356,228,911 | 340,265,618 |
| MEMBERS' EQUITY | | |
| Capital stock and participation certificates | 2,612,165 | 2,620,855 |
| Allocated retained earnings | 12,754,258 | 12,765,444 |
| Unallocated retained earnings | 68,113,193 | 64,072,029 |
| Accumulated other comprehensive income (loss) | 219,029 | 256,170 |
| Total members' equity | 83,698,645 | 79,714,498 |
| Total liabilities and members' equity | \$ 439,927,556 | \$ 419,980,116 |

TEXAS LAND BANK, ACA

Consolidated Statement of Income

(unaudited)

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|--|--------------------------------|---------------------|------------------------------------|---------------------|
| | 2009 | 2008 | 2009 | 2008 |
| INTEREST INCOME | | | | |
| Loans | \$ 6,252,109 | \$ 6,952,704 | \$ 18,927,628 | \$ 20,854,678 |
| Total interest income | 6,252,109 | 6,952,704 | 18,927,628 | 20,854,678 |
| INTEREST EXPENSE | | | | |
| Note payable to the Bank | 3,279,854 | 3,916,780 | 9,952,278 | 11,836,648 |
| Advance conditional payments | - | 151 | 1 | 377 |
| Total interest expense | <u>3,279,854</u> | <u>3,916,931</u> | <u>9,952,279</u> | <u>11,837,025</u> |
| Net interest income | 2,972,255 | 3,035,773 | 8,975,349 | 9,017,653 |
| PROVISION FOR LOSSES | | | | |
| Provision (negative provision) for loan losses | 303,593 | 50,000 | 1,965,507 | 150,000 |
| Provision for acquired property losses | - | - | - | - |
| Net interest income after provision for loan losses | 2,668,662 | 2,985,773 | 7,009,842 | 8,867,653 |
| NONINTEREST INCOME | | | | |
| Income from the bank: | | | | |
| Patronage income | 61,959 | 70,330 | 192,475 | 220,014 |
| Loan fees | 237,911 | 243,063 | 1,008,595 | 946,847 |
| Financially related services income | 3,247 | 3,273 | 11,521 | 12,012 |
| Gain (loss) on sale of premises and equipment, net | (147) | 717 | 6,515 | (3,296) |
| Other noninterest income | 4,541 | 202 | 30,048 | 42,593 |
| Total noninterest income | 307,511 | 317,585 | 1,249,154 | 1,218,170 |
| NONINTEREST EXPENSES | | | | |
| Salaries and employee benefits | 770,986 | 678,599 | 2,367,059 | 2,009,021 |
| Directors' expense | 30,142 | 43,906 | 169,178 | 172,207 |
| Purchased services | 107,687 | 145,759 | 329,371 | 376,716 |
| Travel | 26,359 | 33,474 | 72,792 | 103,810 |
| Occupancy and equipment | 65,218 | 55,295 | 212,323 | 200,035 |
| Communications | 20,082 | 19,165 | 59,350 | 54,676 |
| Advertising | 82,728 | 74,263 | 199,255 | 216,977 |
| Public and member relations | 15,125 | 30,754 | 74,571 | 73,375 |
| Supervisory and exam expense | 36,317 | 34,221 | 108,951 | 102,661 |
| Insurance Fund premiums | 166,349 | 122,770 | 487,067 | 414,836 |
| Other noninterest expense | 42,964 | 35,764 | 137,915 | 143,225 |
| Total noninterest expenses | 1,363,957 | 1,273,970 | 4,217,832 | 3,867,539 |
| Income before income taxes | 1,612,216 | 2,029,388 | 4,041,164 | 6,218,284 |
| Provision for (benefit from) income taxes | - | - | - | - |
| Net income | \$ 1,612,216 | \$ 2,029,388 | \$ 4,041,164 | \$ 6,218,284 |

TEXAS LAND BANK, ACA

Consolidated Statement of Changes in Members' Equity
(unaudited)

| | Capital Stock/ Participation Certificates | Retained Earnings | | Accumulated Other Comprehensive Income (Loss) | Total Members' Equity |
|--|---|-----------------------------|-----------------------------|--|-----------------------------|
| | | Allocated | Unallocated | | |
| Balance at December 31, 2007 | \$ 2,660,520 | \$ 8,645,124 | \$ 64,088,861 | \$ 284,093 | \$ 75,678,598 |
| Comprehensive income | | | | | |
| Net income | - | - | 6,218,284 | - | 6,218,284 |
| Other comprehensive income | | | | | |
| Prior service credits (costs) | - | - | - | (38,868) | (38,868) |
| Actuarial gains (losses) | - | - | - | 612 | 612 |
| Other comprehensive income | - | - | - | (38,256) | (38,256) |
| Comprehensive income | - | - | 6,218,284 | (38,256) | 6,180,028 |
| Effects of accounting change regarding measurement date of postretirement benefits plans pursuant to FASB Statement No. 158 | | | | | |
| Service and interest costs for October 1 - December 31, net of tax | - | - | (21,417) | - | (21,417) |
| Amortization of prior service credits for October 1 - December 31, net of tax | - | - | 12,956 | - | 12,956 |
| Additional net loss, October 1 - December 31, net of tax | - | - | (204) | - | (204) |
| Statement No. 158 | - | - | (8,665) | - | (8,665) |
| Capital stock/participation certificates issued | 271,675 | - | - | - | 271,675 |
| Capital stock/participation certificates and allocated retained earnings retired | (260,740) | - | - | - | (260,740) |
| Patronage refunds: | | | | | |
| Capital stock/participation certificates and allocated retained earnings | - | (6,243) | - | - | (6,243) |
| Balance at September 30, 2008 | <u>\$ 2,671,455</u> | <u>\$ 8,638,881</u> | <u>\$ 70,298,480</u> | <u>\$ 245,837</u> | <u>\$ 81,854,653</u> |
| Balance at December 31, 2008 | \$ 2,620,855 | \$ 12,765,444 | \$ 64,072,029 | \$ 256,170 | \$ 79,714,498 |
| Comprehensive income | | | | | |
| Net income | - | - | 4,041,164 | - | 4,041,164 |
| Amortization of costs included in periodic retirement benefit costs | - | - | - | (37,141) | (37,141) |
| Total comprehensive income | - | - | 4,041,164 | (37,141) | 4,004,023 |
| Capital stock/participation certificates issued | 223,720 | - | - | - | 223,720 |
| Capital stock/participation certificates and allocated retained earnings retired | (232,410) | - | - | - | (232,410) |
| Patronage refunds: | | | | | |
| Capital stock/participation certificates and allocated retained earnings | - | (11,186) | - | - | (11,186) |
| Balance at September 30, 2009 | <u>\$ 2,612,165</u> | <u>\$ 12,754,258</u> | <u>\$ 68,113,193</u> | <u>\$ 219,029</u> | <u>\$ 83,698,645</u> |

TEXAS LAND BANK, ACA

Notes to the Consolidated Financial Statements (Unaudited)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Texas Land Bank, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes in the counties of Bell, Bosque, Burnet, Coryell, Dallas, Ellis, Falls, Freestone, Hamilton, Hill, Lampasas, Limestone, McLennan, Milam, Navarro and Williamson in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

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

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

This guidance also requires a reporting entity to make additional disclosures in interim and annual periods. It is effective for interim periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. Revisions resulting from change in valuation techniques or their application are accounted for as a change in accounting estimate. The Association adopted the guidance in second quarter 2009. The adoption did not have a material impact on the financial condition or results of operations of the Association.

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

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

The guidance was effective for interim and annual periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. For securities held at the beginning of the interim period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell and it is more likely than not that it will be required to sell before recovery of its amortized cost basis, the entity shall recognize the cumulative effect of initially applying this guidance as an adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. The Association held no investments in debt securities during the first nine months of 2009. Therefore, although the Association adopted the guidance, it did not recognize an adjustment to beginning retained earnings or accumulated other comprehensive income since no impairment losses were previously recognized.

In May 2009, the FASB issued guidance, “Subsequent Events”, which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). Recognized subsequent events should be recognized in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not recognized in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was effective for interim or annual periods ending after June 15, 2009.

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

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

NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

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 table presents information concerning impaired loans:

| | September 30, 2009 | September 30, 2008 |
|---|-------------------------------|-----------------------|
| Impaired loans with related allowance | \$ 5,557,338 | \$ - |
| Impaired loans with no related allowance | 3,382,814 | 268,585 |
| Total impaired loans | <u>\$ 8,940,152</u> | <u>\$ 268,585</u> |
| Allowance on impaired loans | \$ 1,882,166 | \$ - |
| Average impaired loans | \$ 7,580,063 | \$ 674,583 |
| Interest income on impaired loans for the quarter | \$ 2,665 | \$ 5,455 |

The Association portfolio included \$8,940,152 in loans classified as impaired as of June 30, 2009. This represented an increase of \$8,671,567 from the same period in 2008. \$8,931,438 of total impaired loans were also classified as nonaccrual as of September 30, 2009, with 100 percent of those current as to principal and interest. Total impaired loan volume was primarily driven by six participation loans. Based on guidance from the Farm Credit Administration (FCA) and the lead lenders in addition to analysis performed by the Association, related specific allowances have been recorded on all but one of those six impaired loans. Using data provided to the Association it was determined that while there was enough concern regarding the viability of that particular borrower going forward to prevent the loan from being upgraded to nonaccrual cash basis, the loan continued to be well secured and did not warrant a specific allowance as of September 30, 2009.

The allowance for loan losses is maintained based on estimates that consider the general financial strength of the overall general and agricultural economies, loan portfolio composition, credit administration and the portfolio's prior loan loss experience. Using these factors, the Association maintains an allowance for loan loss level that is considered adequate by management to provide for estimated losses inherent in the loan portfolio. An analysis of the allowance for loan losses follows:

| | September 30, 2009 | September 30, 2008 |
|---------------------------------|-------------------------------|-----------------------|
| Balance at beginning of quarter | \$ 2,039,236 | \$ 182,663 |
| Provision for loan losses | 303,593 | 50,000 |
| Charge-offs | - | - |
| Recoveries | - | - |
| Balance at end of quarter | <u>\$ 2,342,829</u> | <u>\$ 232,663</u> |

The allowance for loan loss was \$2,110,166 higher for the quarter ended September 30, 2009, as compared to the same period in 2008. In addition to a \$200,000 increase in the general allowance since September 30, 2008, this increase was primarily attributable to an increase in the specific allowance for loan loss provision that was warranted by five participation loans in which it was deemed that there was a weak collateral position and negative economic conditions impacting the related industries as of September 30, 2009.

NOTE 3 — CAPITAL:

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

NOTE 4 — INCOME TAXES:

Texas Land Bank, ACA and its subsidiary are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During 2008, the Association participated in a patronage program and intends to do so again in 2009. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The Association has recorded a full valuation allowance against its deferred tax asset as of September 30, 2009, based on management's estimate that it is more likely than not that the deferred tax asset will not be realized. For the nine months ended September 30, 2009, net income for tax purposes did not warrant the recognition of tax expense due to the patronage program implemented.

The subsidiary, Texas Land Bank, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

Upon adoption of FIN 48 on January 1, 2007, the Association did not recognize a tax liability for any unrecognized tax benefits.

NOTE 5 — FAIR VALUE MEASUREMENTS:

Authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 11 to the 2008 Annual Report to Stockholders for a more complete description.

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

| | Fair Value Measurement Using | | | Total Fair Value | Total Gains (losses) |
|---------|------------------------------|---------|--------------|------------------|----------------------|
| | Level 1 | Level 2 | Level 3 | | |
| Assets: | | | | | |
| Loans * | \$ - | \$ - | \$ 3,675,172 | \$ 3,675,172 | \$ - |

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

Valuation Techniques

As more fully discussed in Note 11 to the 2008 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Bank and its related Associations' assets and liabilities. For a more complete description, see Notes to the 2008 Annual Report.

Loans

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

NOTE 6 — EMPLOYEE BENEFIT PLANS:

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

| | Other Benefits | |
|-------------------------------------|----------------|-----------|
| | 2009 | 2008 |
| Service cost | \$ 21,363 | \$ 19,098 |
| Interest cost | 45,702 | 45,153 |
| Expected return on plan assets | - | - |
| Amortization of prior service costs | (38,380) | (38,868) |
| Amortizations of net (gain) loss | 1,239 | 612 |
| Net periodic benefit cost | \$ 29,924 | \$ 25,995 |

The Association previously disclosed in its financial statements for the year ended December 31, 2008, that it expected to contribute \$864,643 to its defined benefit pension plan in 2009. The Association has now funded the full amount for 2009, and it does not anticipate contributing any additional amounts in 2009. The amount will be recognized as an expense for the Association on a pro rata basis throughout the year.

NOTE 7 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through November 6, 2009, which is the date the financial statements were issued. As of November 6, 2009, there were no significant events requiring disclosure in the third quarter 2009 stockholder report.