

# **2011 Quarterly Report**

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**For the 3<sup>rd</sup> Quarter Ended September 30, 2011**

## 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 7, 2011*



Barnett L. Baker  
Chairman, Board of Directors  
*November 7, 2011*



Sharla Chambers  
Chief Financial Officer  
*November 7, 2011*

**TEXAS LAND BANK, ACA  
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, 2011. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2010 Annual Report to Stockholders.

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.

**LOAN PORTFOLIO:**

The Association makes and services loans to farmers, ranchers, rural homeowners, and certain farm-related businesses, primarily in the 16-county Central Texas trade area located in the I-35 Corridor between the metropolitan areas of Dallas/Fort Worth and Austin. The Association's total loan volume consists of long term rural real estate mortgage loans, production and intermediate term loans, farm-related business loans and rural home loans.

Total loans outstanding at September 30, 2011, including nonaccrual loans and sales contracts, were \$461,099,877 compared to \$437,291,603 at December 31, 2010, reflecting an increase of 5.4 percent. The increase in volume is primarily related to real estate mortgage loans. While this area of Texas has experienced a decline in the number of land sales transactions, it has continued to experience relatively stable values in the past five years.

The primary commodity source for the Association's loan portfolio is livestock, excluding dairy and poultry. Cattle prices have been stable and are being aided by lower inventory numbers. However, grain prices have been trading above average historical ranges, and this has affected feed costs, negatively impacting livestock and poultry producers. Economists are predicting grain prices to continue trading at these higher levels throughout 2011 and could continue to be a concern for meat producers. Lower than normal cow herd numbers should, however, maintain a favorable supply/demand environment for ranchers as consumer demand for meat and meat products remains stable.

Unfortunately, even though some commodity markets are positive, operating conditions in the 16-county area serviced by the Association are difficult at this time. The intense heat experienced during the summer months and rainfall levels that are well below average have adversely affected production. Pasture conditions were well below average during the first half of the year and have remained that way into the early fall months. Operators continue to be concerned about production cost volatility, particularly fuel, fertilizer, feed, and chemical costs. The current weather pattern, related drought, and potential continuing impact on yields and production is of high concern for producers in our growing area at this time.

Although there are still lingering concerns about the global and national economies, the recovery process following the Great Recession, and the impact at the local level, the local economy generally continues to outperform the national economy and provide stability for off-farm income sources. The Association has significant monthly payment loan volume and loans to borrowers that are not dependent solely upon farm income for repayments. Thus, the Association does not experience large fluctuations due to seasonal characteristics.

**RISK EXPOSURE:**

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

	<u>September 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 528,037	36.0%	\$ 1,127,210	76.4%
90 days past due and still accruing interest	-	0.0%	-	0.0%
Formally restructured	593,202	40.4%	-	0.0%
Other property owned, net	347,430	23.7%	347,430	23.6%
Total	<u>\$ 1,468,669</u>	<u>100.1%</u>	<u>\$ 1,474,640</u>	<u>100.0%</u>

Total high risk assets as of September 30, 2011, were \$1,468,669, as compared to \$1,474,640 as of December 31, 2010, which represented a .4 percent decrease, resulting from a decrease in nonaccrual loans, offset by an increase in formally restructured loans.

Nonaccrual loans as a percentage of total loans outstanding were 0.1 percent at September 30, 2011, compared to 0.3 percent at December 31, 2010. The decrease was primarily related to a capital markets participation loan in the ethanol industry which was transferred back to accrual status during the second quarter of 2011 when warranted by improved performance and operating conditions. Although the loan was transferred back to accrual status and was a performing loan as of September 30, 2011, the conditions and structure of the loan mandated it being classified as formally restructured.

Other property owned remained unchanged as of September 30, 2011, as compared to December 31, 2010. The amount consisted of a capital markets participation loan in the ethanol industry that went into foreclosure whose collateral was acquired by the lender group in June 2010. The Association, along with all other participating lenders, received an equity position in the borrowing entity in exchange for concession of a portion of the debt. The equity was valued at \$347,430 and an acquired property was recognized for this amount.

The Association recorded \$70,711 in recoveries and \$3,019 in charge-offs for the quarter ending September 30, 2011, and \$0 in recoveries and \$298,497 in charge-offs for the same period in 2010. The Association's allowance for loan losses was 0.2 percent and 0.2 percent of total loans outstanding as of September 30, 2011, and December 31, 2010, respectively. Management and the Association Audit Committee have reviewed the composition of the loan portfolio and feel that loans that could present a problem have been satisfactorily identified and adjustments have been appropriately made in order to ensure that the allowance for loan loss balance is adequate at this time.

The overall quality of the loan portfolio remained strong through the third quarter of 2011, with loans classified under Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" at 98.4 percent of total loans and accrued interest as of September 30, 2011.

## **RESULTS OF OPERATIONS:**

### *Net Income*

The Association had net income of \$2,647,661 and \$7,093,246 for the three and nine months ended September 30, 2011, as compared to net income of \$2,572,033 and \$7,311,434 for the same periods in 2010. The increase of 2.9 percent for the three months is primarily related to higher net interest income and lower noninterest expenses as compared to the same period in 2010. The 3.0 percent decrease for the nine months is a result of higher net interest income offset by a material decrease in noninterest income recognized and slightly higher noninterest expenses as compared to the same period in 2010.

### *Net Interest Income*

Net interest income was \$3,513,201 and \$10,280,795 for the three and nine months ended September 30, 2011, compared to \$3,277,849 and \$9,759,905 for the same periods in 2010. Interest income for the three and nine months of 2011 decreased by \$151,803, or 2.4 percent and \$723,920, or 3.8 percent, from the same periods of 2010, primarily due to declines in yields on earning assets offset by an increase in average loan volume as average loan volume for the third quarter of 2011 was \$447,848,569, compared to \$438,976,658 in the third quarter of 2010. In spite of an increase in average loan volume, interest expense for the three and nine months of 2011 decreased by \$387,155, or 12.4 percent and \$1,244,810, or 13.1 percent, from the same periods of 2010 due to a decrease in interest rates. The factors impacting interest income and interest expense produced an average spread on the loan portfolio for the third quarter of 2011 equal to 2.53 percent, compared to 2.33 percent in the third quarter of 2010.

### *Noninterest Income and Expense*

Noninterest income was \$216,415 and \$653,745 for the three and nine months ended September 30, 2011, and \$466,004 and \$1,425,174 for the same periods in 2010. The decrease is primarily the result of the Association's implementation of authoritative accounting guidance in the fourth quarter of 2010 requiring the capitalization and amortization of loan origination fees and costs for loans closed resulting in the capitalization of \$327,456 in loan origination fees in the first nine months of 2011 that will be amortized over the life of the loans as an adjustment to yield in net interest income. Noninterest expenses were \$1,176,343 and \$3,901,601 for the three and nine months ended September 30, 2011, as compared to \$1,297,742 and \$3,872,468 for the same periods in 2010. The increase for the first nine months of 2011 as compared to the same period in 2010 is primarily attributable to an increase in salary and benefits expenses related to increased pension plan costs and the funding of a nonqualified benefit trust, offset by a \$477,730 decrease in salary and benefits as a result of the Association's implementation of authoritative accounting guidance in the fourth quarter of 2010 requiring the capitalization of origination costs consisting of salaries and benefits, which will be amortized over the life of the loans as an adjustment to yield in net interest income.

## Financial and Performance Ratios

The Association's return on average assets for the nine months ended September 30, 2011, was 2.09 percent compared to 2.18 percent for the same period in 2010. The Association's return on average equity for the nine months ended September 30, 2011, was 9.99 percent, compared to 11.04 percent for the same period in 2010. These declines are a result of decreased net income as discussed above.

## LIQUIDITY AND FUNDING SOURCES:

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

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Note payable to the Bank	\$ <b>372,593,021</b>	\$ 351,233,934
Accrued interest on note payable	<b>893,372</b>	989,246
Total	<b>\$ 373,486,393</b>	\$ 352,223,180

The Association experienced a 6.0 percent increase in notes and accrued interest payable to the Bank through the nine months ended September 30, 2011, due to an increase in loan volume experienced by the Association since December 31, 2010.

## CAPITAL RESOURCES:

The Association's capital position increased by \$7,121,169 at September 30, 2011, compared to December 31, 2010. The Association's debt as a percentage of members' equity was 3.81:1 as of September 30, 2011, compared to 3.91:1 as of December 31, 2010.

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, 2011, was 19.8 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, 2011, were 19.2 and 19.2 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

## SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS:

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Comprehensive Income – Presentation of Comprehensive Income." This guidance is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements:

- A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income.
- In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income.

This guidance is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

In May 2011, the FASB issued guidance entitled, "Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments change the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following:

1. Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities).

2. Aligning the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a market participant that holds the instruments as assets.
3. Clarifying that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.
4. An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks.
5. Clarifying that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity's holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance.
6. Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed.

The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In January 2011, the FASB issued guidance entitled, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings required by the guidance previously issued on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The effective date of the new disclosures about troubled debt restructurings (TDR) coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes a TDR. In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The Association is currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the Financial Accounting Standards Board (FASB) issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses," which is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this Standard did not impact the Association's financial condition or results of operations, but did result in significant additional disclosures.

In January 2010, the FASB issued guidance on "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association's financial condition or results of operations but did result in additional disclosures.

## **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, 2010 Annual Report of Texas Land Bank, ACA more fully describe the Association's relationship with the Bank.

The Texas 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) 483-9204. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcf@farmcreditbank.com](mailto:fcf@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its website at [www.farmcreditbank.com](http://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 also 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](mailto:sharla.chambers@texaslandbank.com) or accessed on the Association's website at [www.texaslandbank.com](http://www.texaslandbank.com).

**TEXAS LAND BANK, ACA**

**CONSOLIDATED BALANCE SHEET**

	September 30, 2011 (unaudited)	December 31, 2010
<b><u>ASSETS</u></b>		
Cash	\$ 529,129	\$ 754,776
Loans	461,099,877	437,291,603
Less: allowance for loan losses	818,227	842,968
Net loans	460,281,650	436,448,635
Accrued interest receivable	4,468,254	3,563,905
Investment in and receivable from the Bank:		
Capital stock	7,148,785	7,148,785
Other property owned, net	347,430	347,430
Premises and equipment	1,397,701	1,473,212
Other assets	580,719	170,317
Total assets	\$ 474,753,668	\$ 449,907,060
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 372,593,021	\$ 351,233,934
Accrued interest payable	893,372	989,246
Drafts outstanding	426,925	371,770
Patronage distributions payable	-	3,852,577
Other liabilities	2,051,053	1,791,405
Total liabilities	375,964,371	358,238,932
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,712,735	2,664,165
Allocated retained earnings	15,754,288	15,753,946
Unallocated retained earnings	80,448,348	73,356,064
Accumulated other comprehensive income (loss)	(126,074)	(106,047)
Total members' equity	98,789,297	91,668,128
Total liabilities and members' equity	\$ 474,753,668	\$ 449,907,060

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

TEXAS LAND BANK, ACA

CONSOLIDATED STATEMENT OF INCOME  
(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 6,248,974	\$ 6,400,777	\$ 18,514,418	\$ 19,238,338
Total interest income	<b>6,248,974</b>	6,400,777	<b>18,514,418</b>	19,238,338
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	2,735,773	3,122,928	8,233,623	9,478,433
Total interest expense	<b>2,735,773</b>	3,122,928	<b>8,233,623</b>	9,478,433
Net interest income	<b>3,513,201</b>	3,277,849	<b>10,280,795</b>	9,759,905
<b><u>PROVISION FOR LOSSES</u></b>				
Provision (negative provision) for loan losses	(94,388)	(124,500)	(60,307)	(4,686)
Provision for acquired property losses		(1,422)		5,863
Total provision for losses	<b>(94,388)</b>	(125,922)	<b>(60,307)</b>	1,177
Net interest income after provision for loan losses	<b>3,607,589</b>	3,403,771	<b>10,341,102</b>	9,758,728
<b><u>NONINTEREST INCOME</u></b>				
Income from the Bank:				
Patronage income	53,597	58,741	163,896	181,161
Loan fees	160,040	374,129	445,180	773,967
Financially related services income	2,778	3,079	8,991	11,020
Gain (loss) on other property owned, net	-	30,040	-	30,856
Other noninterest income	-	15	35,678	428,170
Total noninterest income	<b>216,415</b>	466,004	<b>653,745</b>	1,425,174
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	659,227	759,217	2,367,225	2,258,399
Directors' expense	54,657	47,284	161,290	188,038
Purchased services	67,671	108,614	241,446	375,299
Travel	39,366	34,282	121,389	93,943
Occupancy and equipment	77,187	72,238	214,344	206,631
Communications	25,961	26,722	73,676	69,183
Advertising	76,907	82,562	210,263	214,691
Public and member relations	20,873	20,833	77,107	76,239
Supervisory and exam expense	43,051	39,111	129,155	117,329
Insurance Fund premiums	50,046	42,324	149,750	127,740
(Gain)/loss on sale of premises and equipment, net	2,615	5,123	2,615	8,053
Other noninterest expense	58,782	59,432	153,341	136,923
Total noninterest expenses	<b>1,176,343</b>	1,297,742	<b>3,901,601</b>	3,872,468
Income before income taxes	<b>2,647,661</b>	2,572,033	<b>7,093,246</b>	7,311,434
Net income	<b>\$ 2,647,661</b>	\$ 2,572,033	<b>\$ 7,093,246</b>	\$ 7,311,434

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

TEXAS LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Additional Paid-in-Capital</u>	<u>Retained Earnings</u>		<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
			<u>Allocated</u>	<u>Unallocated</u>		
Balance at December 31, 2009	\$ 2,623,015	\$ -	\$ 14,254,258	\$ 67,792,972	\$ 291,739	\$ 84,961,984
Comprehensive income						
Net income	-	-	-	7,311,434	-	7,311,434
Change in postretirement benefit plans	-	-	-	-	(38,379)	(38,379)
Total comprehensive income	-	-	-	7,311,434	(38,379)	7,273,055
Capital stock/participation certificates and allocated retained earnings issued	245,800	-	-	-	-	245,800
Capital stock/participation certificates and allocated retained earnings retired	(209,920)	-	-	-	-	(209,920)
Patronage refunds:						
Change in estimated patronage declared in 2009 and paid in 2010	-	-	(312)	(58)	-	(370)
Balance at September 30, 2010	<u>\$ 2,658,895</u>	<u>\$ -</u>	<u>\$ 14,253,946</u>	<u>\$ 75,104,348</u>	<u>\$ 253,360</u>	<u>\$ 92,270,549</u>
Balance at December 31, 2010	\$ 2,664,165	\$ -	\$ 15,753,946	\$ 73,356,064	\$ (106,047)	\$ 91,668,128
Comprehensive income						
Net income	-	-	-	7,093,246	-	7,093,246
Change in postretirement benefit plans	-	-	-	-	(20,027)	(20,027)
Total comprehensive income	-	-	-	7,093,246	(20,027)	7,073,219
Capital stock/participation certificates and allocated retained earnings issued	254,175	-	-	-	-	254,175
Capital stock/participation certificates and allocated retained earnings retired	(205,605)	-	-	-	-	(205,605)
Patronage refunds:						
Change in estimated patronage declared in 2010 and paid in 2011	-	-	342	(962)	-	(620)
Balance at September 30, 2011	<u>\$ 2,712,735</u>	<u>\$ -</u>	<u>\$ 15,754,288</u>	<u>\$ 80,448,348</u>	<u>\$ (126,074)</u>	<u>\$ 98,789,297</u>

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

**TEXAS LAND BANK, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

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

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.

The significant accounting policies followed and the financial condition and results of operations of the Association as of and for the year ended December 31, 2010, are contained in the 2010 Annual Report to Stockholders. These unaudited third quarter 2011 financial statements should be read in conjunction with the 2010 Annual Report to Stockholders.

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, “Comprehensive Income – Presentation of Comprehensive Income.” This guidance is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements:

- A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income.
- In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income.

This guidance is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

In May 2011, the FASB issued guidance entitled, “Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs.” The amendments change the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following:

1. Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities).
2. Aligning the fair value measurement of instruments classified within an entity’s shareholders’ equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a market participant that holds the instruments as assets.
3. Clarifying that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.
4. An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks.
5. Clarifying that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity’s holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance.
6. Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed.

The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In January 2011, the FASB issued guidance entitled, “Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings.” This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings required by the guidance previously issued on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” The effective date of the new disclosures about troubled debt restructurings (TDR) coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, “A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring,” which provides for clarification on whether a restructuring constitutes a TDR. In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The Association is currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the FASB issued guidance on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses,” which is intended to provide additional information to assist financial statement users in assessing an entity’s credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this Standard did not impact the Association’s financial condition or results of operations, but did result in additional disclosures.

In January 2010, the FASB issued guidance on “Fair Value Measurements and Disclosures,” which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association’s financial condition and results of operations but did result in additional disclosures.

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 ended September 30, 2011, are not necessarily indicative of the results to be expected for the year ended December 31, 2011. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

## **NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans in the Association’s portfolio follows:

Loan Type	September 30,	December 31,
	2011	2010
	Amount	Amount
Production agriculture:		
Real estate mortgage	\$ 399,962,769	\$ 377,910,701
Production and intermediate term	19,594,618	19,144,244
Agribusiness:		
Loans to cooperatives	2,786,616	1,884,412
Processing and marketing	12,571,323	9,889,469
Farm-related business	2,231,516	1,682,310
Communication	3,048,247	4,549,008
Energy	9,363,641	10,984,405
Rural residential real estate	11,541,147	11,247,054
Total	\$ 461,099,877	\$ 437,291,603

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at September 30, 2011:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 17,318,980	\$ 4,989,716	\$ -	\$ -	\$ 17,318,980
Production and intermediate term	6,071,968	323,148	-	-	6,071,968	323,148
Agribusiness	15,084,732	-	-	-	15,084,732	-
Communication	3,048,247	-	-	-	3,048,247	-
Energy	9,363,641	-	-	-	9,363,641	-
Total	\$ 50,887,568	\$ 5,312,864	\$ -	\$ -	\$ 50,887,568	\$ 5,312,864

Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

	September 30,	December 31,
	2011	2010
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 527,707	\$ 1,127,210
Production and intermediate term	330	-
Total nonaccrual loans	528,037	1,127,210
<b>Accruing restructured loans:</b>		
Real estate mortgage	593,202	-
Total accruing restructured loans	593,202	-
<b>Accruing loans 90 days or more past due:</b>		
Total accruing loans 90 days or more	-	-
Total nonperforming loans	1,121,239	1,127,210
Other property owned	347,430	347,430
Total nonperforming assets	\$ 1,468,669	\$ 1,474,640

Total nonperforming assets, primarily composed of real estate mortgage assets, as of September 30, 2011, were \$1,468,669, as compared to \$1,474,640 as of December 31, 2010, which represented a .4 percent decrease, resulting from a decrease in nonaccrual loans, offset by an increase in formally restructured loans.

Nonaccrual loans as a percentage of total loans outstanding were 0.1 percent at September 30, 2011, compared to 0.3 percent at December 31, 2010. The decrease was primarily related to a capital markets participation loan in the ethanol industry which was transferred back to accrual status, per the lead lender, during the second quarter of 2011 when warranted by improved performance and operating conditions. Although the loan was transferred back to accrual status and was a performing loan as of September 30, 2011, the conditions and structure of the loan mandated it being classified as formally restructured.

Other property owned remained unchanged as of September 30, 2011, as compared to December 31, 2010. The amount consisted of a capital markets participation loan in the ethanol industry that went into foreclosure whose collateral was acquired by the Association in June 2010. The Association, along with all other participating lenders, received an equity position in the borrowing entity in exchange for concession of a portion of the debt. The equity was valued at \$347,430 and an acquired property was recognized for this amount.

One credit quality indicator utilized by the Association is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality,
- Other assets especially mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness,
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Real estate mortgage		
Acceptable	<b>95.1 %</b>	94.9 %
OAEM	<b>3.6</b>	3.6
Substandard/doubtful	<b>1.3</b>	1.5
	<b>100.0</b>	100.0
Production and intermediate term		
Acceptable	<b>70.5</b>	83.5
OAEM	<b>29.5</b>	16.5
Substandard/doubtful	<b>-</b>	-
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	<b>80.2</b>	67.8
OAEM	<b>8.5</b>	16.7
Substandard/doubtful	<b>11.3</b>	15.5
	<b>100.0</b>	100.0
Energy and water/waste disposal		
Acceptable	<b>86.0</b>	100.0
OAEM	<b>14.0</b>	-
Substandard/doubtful	<b>-</b>	-
	<b>100.0</b>	100.0
Communication		
Acceptable	<b>100.0</b>	100.0
OAEM	<b>-</b>	-
Substandard/doubtful	<b>-</b>	-
	<b>100.0</b>	100.0
Rural residential real estate		
Acceptable	<b>98.7</b>	92.3
OAEM	<b>0.3</b>	6.5
Substandard/doubtful	<b>1.0</b>	1.2
	<b>100.0</b>	100.0
Total Loans		
Acceptable	<b>93.4</b>	93.7
OAEM	<b>5.0</b>	4.5
Substandard/doubtful	<b>1.6</b>	1.8
	<b>100.0 %</b>	100.0 %

The following table provides an age analysis of past due loans (including accrued interest) as of September 30, 2011:

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 304,900	\$71,096	\$ 375,996	\$ 403,688,781	\$ 404,064,777	\$ -
Production and intermediate term	-	330	330	19,821,630	19,821,960	-
Loans to cooperatives	-	-	-	2,790,721	2,790,721	-
Processing and marketing	-	-	-	12,598,774	12,598,774	-
Farm-related business	-	-	-	2,264,828	2,264,828	-
Communication	-	-	-	3,062,444	3,062,444	-
Energy and water/waste disposal	-	-	-	9,372,360	9,372,360	-
Rural residential real estate	165,791	-	165,791	11,426,476	11,592,267	-
Total	\$ 470,691	\$71,426	\$ 542,117	\$ 465,026,014	\$ 465,568,131	\$ -

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

Additional impaired loan information is as follows:

	At September 30, 2011			For the Three Months Ended September 30, 2011		For the Nine Months Ended September 30, 2011	
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:							
Real estate mortgage	\$ 362,788	\$ 375,506	\$ 109,930	\$ 363,513	\$ -	\$ 381,963	\$ -
Total	\$ 362,788	\$ 375,506	\$ 109,930	\$ 363,513	\$ -	\$ 381,963	\$ -
Impaired loans with no related allowance for credit losses:							
Real estate mortgage	\$ 164,919	\$ 165,643	\$ -	\$ 436,394	\$ 42,140	\$ 1,180,489	\$ 58,774
Production and intermediate term	330	3,350	-	110	-	37	-
Total	\$ 165,249	\$ 168,993	\$ -	\$ 436,504	\$ 42,140	\$ 1,180,526	\$ 58,774
Total impaired loans:							
Real estate mortgage	\$ 527,707	\$ 541,149	\$ 109,930	\$ 799,907	\$ 42,140	\$ 1,562,452	\$ 58,774
Production and intermediate term	330	3,350	-	110	-	37	-
Total	\$ 528,037	\$ 544,499	\$ 109,930	\$ 800,017	\$ 42,140	\$ 1,562,489	\$ 58,774

	At December 31, 2010			For the Year Ended December 31, 2010	
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 427,870	\$ 427,870	\$ 2,615	\$ 988,609	\$ -
Total	\$ 427,870	\$ 427,870	\$ 2,615	\$ 988,609	\$ -
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 699,340	\$ 699,340	\$ -	\$ 935,069	\$ 60,661
Processing and marketing	-	-	-	210,168	7,204
Total	\$ 699,340	\$ 699,340	\$ -	\$ 1,145,237	\$ 67,865
Total impaired loans:					
Real estate mortgage	\$ 1,127,210	\$ 1,127,210	\$ 2,615	\$ 1,923,678	\$ 60,661
Processing and marketing	-	-	-	210,168	7,204

<sup>a</sup> Unpaid principal balance represents the recorded principal balance of the loan.

The allowance for loan loss is based on a periodic evaluation of the loan portfolio by management and the Association Audit Committee in which numerous factors are considered, including the overall general and agricultural economic conditions, loan portfolio composition, credit administration, and the portfolio's prior loan loss experience. Using these factors, the Association maintains an allowance level that is considered adequate by management to provide for estimated losses inherent in the loan portfolio. A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Disposal	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>							
Balance at							
December 31, 2010	\$ 421,809	\$ 40,505	\$ 313,882	\$ 30,527	\$ 21,586	\$ 14,659	\$ 842,968
Charge-offs	(83,430)	(3,019)	-	-	-	-	(86,449)
Recoveries	70,711	-	-	-	51,304	-	122,015
Provision for loan losses	103,876	(8,911)	(112,532)	(18,943)	(23,379)	(418)	(60,307)
Other	-	-	-	-	-	-	-
Balance at							
September 30, 2011	\$ 512,966	\$ 28,575	\$ 201,350	\$ 11,584	\$ 49,511	\$ 14,241	\$ 818,227
Ending Balance:							
individually evaluated for impairment	\$ 109,930	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 109,930
Ending Balance:							
collectively evaluated for impairment	\$ 403,036	\$ 28,575	\$ 201,350	\$ 11,584	\$ 49,511	\$ -	\$ 694,056
Ending Balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Recorded Investments in Loans Outstanding:</b>							
Ending Balance at							
September 30, 2011	\$ 404,064,777	\$ 19,821,960	\$ 17,654,323	\$ 3,062,444	\$ 9,372,360	\$ 11,592,267	\$ 465,568,131
Ending Balance for loans individually evaluated for impairment	\$ 362,788	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 362,788
Ending Balance for loans collectively evaluated for impairment	\$ 403,701,989	\$ 19,821,960	\$ 17,654,323	\$ 3,062,444	\$ 9,372,360	\$ 11,592,267	\$ 465,205,343
Ending Balance for loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

### 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 the nine months ended September 30, 2011, the Association participated in a patronage program. 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 (more than 50 percent probability), based on management's estimate, that they will not be realized. For the nine months ended September 30, 2011, and 2010 net income for tax purposes did not warrant the recognition of tax expense due to the implemented patronage program.

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. Since that time, there have not been any changes in tax positions.

**NOTE 5 — FAIR VALUE MEASUREMENTS:**

FASB 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 2010 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

<u>September 30, 2011</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Investments available-for-sale *	\$ -	\$ -	\$ -	\$ -
Assets held in nonqualified benefit trusts	<u>200,805</u>	<u>-</u>	<u>-</u>	<u>200,805</u>
Total assets	<u>200,805</u>	<u>-</u>	<u>-</u>	<u>200,805</u>
Liabilities:				
Standby letters of credit	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

<u>December 31, 2010</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Investments available-for-sale *	\$ -	\$ -	\$ -	\$ -
Assets held in nonqualified benefit trusts	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Liabilities:				
Standby letters of credit	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The table below presents significant transfers in and out of Level 1 during the nine months ended September 30, 2011 for all assets measured at fair value on a recurring basis:

	<u>Total Fair Value Measurement Level 1 Assets</u>	
	<u>Assets Held in Nonqualified Benefits Trusts</u>	
Transfers into Level 1	\$	200,805
Transfers out of Level 1		-

During 2010, the Board of Directors approved the creation of a nonqualified benefit trust to become effective on January 1, 2011, that was funded during the first quarter of 2011. The amount funded into the trust in addition to the gains in asset value comprise the total fair market value of \$200,805 and the only Level 1 asset held by the Association as of September 30, 2011.

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

<u>September 30, 2011</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 252,858	\$ 252,858
Other property owned	-	-	347,430	347,430
<u>December 31, 2010</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 425,255	\$ 425,255
Other property owned	-	-	347,430	347,430

\*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 2010 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 Association's assets and liabilities. For a more complete description, see Notes to the 2010 Annual Report to Stockholders.

#### *Assets Held in Nonqualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

#### *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.

### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value, which is generally determined using appraisals or other indications based on comparable sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

### **NOTE 6 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs of non-pension other postretirement employee benefits for the nine months ended September 30,:

	Other Benefits	
	2011	2010
Service cost	\$ 25,136	\$ 21,816
Interest cost	55,613	42,132
Amortization of prior service costs	(37,481)	(38,379)
Amortizations of net (gain) loss	17,454	-
Net periodic benefit cost	<u>\$ 60,722</u>	<u>\$ 25,569</u>

The structure of the District's defined benefit pension plan is characterized as multi-employer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (Bank and associations). As of September 30, 2011, the Association had made contributions of \$729,797 to the plan. The Association does not anticipate contributing any additional money to the plan in 2011. The total amounts will be recognized as an expense to the Association on a pro rata basis throughout the year.

### **NOTE 7 — COMMITMENTS AND CONTINGENT LIABILITIES:**

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

### **NOTE 8 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through November 7, 2011, which is the date the financial statements were issued. As of November 7, 2011, there were no significant events requiring disclosure in the third quarter stockholder report.