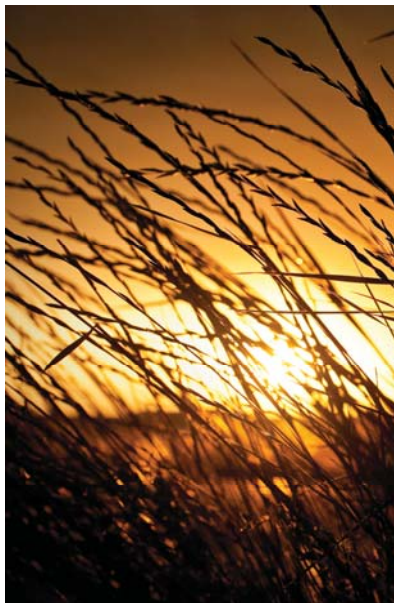


*Annual Report*



*2010*

Dear Stockholders;

On behalf of the Board of Directors and our staff, I invite you to review the attached fiscal year 2010 Annual Report of Financial Condition. As a stockholder, you are an owner of Farm Credit of Southern Colorado and it is important that you know and understand the financial condition of your Association. Your Association continues to perform well and we are excited to share the enclosed information.

The Association had solid performance in the face of continued economic uncertainty and remains strong and sound. We experienced increased profitability in 2010, with positive net earnings of \$10.5 million. As a result of those earnings, the Association will distribute \$2.5 million in cash patronage during 2011.

Loan demand improved in 2010 for core agricultural loans, but our correspondent lending portfolio was down due to stronger competition for agribusiness loans as the general economy slowly improves. Overall Association loan portfolio growth was relatively flat during 2010 with year over year loan volume up 0.58%. Credit quality fluctuated during 2010; however, the Association ended the year with acceptable credit quality that is comparable to historical performance.

We thank you for your continued support and for your business. We know that without you the customer, there would be no Farm Credit of Southern Colorado. We are committed to providing innovative financial solutions to rural America one relationship at a time.

If you have questions, comments or concerns please feel free to contact me at (719) 570-1087.

Thank you,



Russell Tomky  
President and CEO

## Five-Year Summary of Selected Consolidated Financial Data

(Dollars in Thousands)

	December 31				
	2010	2009	2008	2007	2006
<b>Statement of Condition Data</b>					
Loans	\$ 745,510	\$ 734,520	\$ 739,597	\$ 646,654	\$ 585,891
Less allowance for loan losses	3,706	3,401	2,588	2,621	3,769
Net loans	741,804	731,119	737,009	644,033	582,122
Investment in U.S. AgBank, FCB	20,064	20,064	19,481	18,046	17,732
Other property owned	1,812	3,003	-	-	-
Other assets	17,156	21,337	19,829	22,254	18,969
<b>Total assets</b>	<b>\$ 780,836</b>	<b>\$ 775,523</b>	<b>\$ 776,319</b>	<b>\$ 684,333</b>	<b>\$ 618,823</b>
Obligations with maturities of one year or less	\$ 6,093	\$ 4,598	\$ 8,570	\$ 12,156	\$ 8,473
Obligations with maturities longer than one year	605,345	610,950	611,113	523,501	473,740
<b>Total liabilities</b>	<b>611,438</b>	<b>615,548</b>	<b>619,683</b>	<b>535,657</b>	<b>482,213</b>
Protected borrower stock	7	12	21	25	36
Preferred stock	11,726	10,414	10,877	11,964	9,967
Capital stock	1,448	1,486	1,517	1,610	1,662
Unallocated retained earnings	156,059	148,173	144,179	135,195	124,945
Accumulated other comprehensive income/(loss)	158	(110)	42	(118)	-
<b>Total shareholders' equity</b>	<b>169,398</b>	<b>159,975</b>	<b>156,636</b>	<b>148,676</b>	<b>136,610</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 780,836</b>	<b>\$ 775,523</b>	<b>\$ 776,319</b>	<b>\$ 684,333</b>	<b>\$ 618,823</b>
	<b>For the Year Ended December 31</b>				
	2010	2009	2008	2007	2006
<b>Statement of Income Data</b>					
Net interest income	\$ 19,488	\$ 18,534	\$ 19,056	\$ 20,097	\$ 17,054
Patronage distribution from Farm Credit institutions	1,169	342	2,980	3,596	3,330
Provision for loan losses/(Loan loss reversal)	1,518	2,493	20	(1,191)	1,093
Noninterest expense, net	8,571	11,076	8,761	8,342	7,036
Provision for/(Benefit from) income taxes	62	4	29	(13)	50
<b>Net income</b>	<b>\$ 10,506</b>	<b>\$ 5,303</b>	<b>\$ 13,226</b>	<b>\$ 16,555</b>	<b>\$ 12,205</b>
<b>Key Financial Ratios</b>					
<b>For the Year</b>					
Return on average assets	1.38%	0.68%	1.77%	2.63%	2.06%
Return on average shareholders' equity	6.25%	3.31%	8.39%	11.33%	9.20%
Net interest income as a percentage of average earning assets	2.69%	2.50%	2.67%	3.37%	3.04%
Net charge-offs/(recoveries) as a percentage of average net loans	0.17%	0.23%	0.01%	(0.01%)	0.10%
<b>At Year End</b>					
Shareholders' equity as a percentage of total assets	21.69%	20.63%	20.18%	21.73%	22.08%
Debt as a ratio to shareholders' equity	3.61:1	3.85:1	3.96:1	3.60:1	3.53:1
Allowance for loan losses as a percentage of loans	0.50%	0.46%	0.35%	0.41%	0.64%
Permanent capital ratio	19.85%	17.94%	17.83%	21.10%	19.38%
Total surplus ratio	18.01%	16.44%	16.19%	19.10%	17.52%
Core surplus ratio	17.58%	16.44%	16.19%	18.28%	17.52%
<b>Net Income Distribution</b>					
Cash patronage distributions paid	\$ 1,200	\$ 4,000	\$ 6,000	\$ 4,000	\$ 4,000
Cash patronage declared	\$ 2,500	\$ 1,200	\$ 4,000	\$ 6,000	\$ 4,000
Stock dividends declared and paid	\$ 120	\$ 109	\$ 230	\$ 305	\$ 283
<b>Other</b>					
Loans serviced for U.S. AgBank, FCB	\$ -	\$ 5	\$ 16	\$ 16	\$ 23

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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## **INTRODUCTION**

The following discussion summarizes the financial position and results of operations of Farm Credit of Southern Colorado, ACA for the year ended December 31, 2010. Comparisons with prior years are included. We have emphasized material known trends, commitments, events, or uncertainties that have impacted, or are reasonably likely to impact our financial condition and results of operations. You should read these comments along with the accompanying financial statements, footnotes and other sections of this report. The accompanying financial statements were prepared under the oversight of our Audit Committee. The Management's Discussion and Analysis includes the following sections:

- Business Overview
- Economic Overview
- Loan Portfolio
- Credit Risk Management
- Results of Operations
- Liquidity
- Capital Resources
- Regulatory Matters
- Governance
- Forward-Looking Information
- Critical Accounting Policies and Estimates
- Customer Privacy
- Patron's Consent to Take Patronage Distribution Into Income

Our quarterly reports to shareholders are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. The reports may be obtained free of charge on our website, [www.aglending.com](http://www.aglending.com), or upon request. We are located at 3625 Citadel Drive South, Colorado Springs, Colorado 80909 or may be contacted by calling (800) 815-8559.

## **BUSINESS OVERVIEW**

### ***Farm Credit System Structure and Mission***

We are one of approximately 90 associations in the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System mission is to provide sound and dependable credit to American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses through a member-owned cooperative system. This is done by making loans and providing financial services. Through its commitment and dedication to agriculture, the System continues to have the largest portfolio of agricultural loans of any lender in the United States. The Farm Credit Administration (FCA) is the System's independent safety and soundness federal regulator and was established to supervise, examine and regulate System institutions.

### ***Our Structure and Focus***

As a cooperative, we are owned by the members we serve. Our territory served extends across a diverse agricultural region of southern Colorado. The counties in our territory are listed in Note 1 of the accompanying financial statements. We make long-term real estate mortgage loans to farmers, ranchers, rural residents and agribusinesses and production and intermediate-term loans for agricultural production or operating purposes. Additionally, we provide other related services to our borrowers, such as credit life insurance, multi-peril crop and crop hail insurance, appraisal services and an investment stock program. Our success begins with our extensive agricultural experience and knowledge of the market and is dependent on the level of satisfaction we provide to our borrowers.

We obtain the funding for our lending and operations from U.S. AgBank, FCB (AgBank). AgBank is a cooperative of which we are a member. AgBank, its related associations, and AgVantis, Inc. (AgVantis) are referred to as the District. We are materially affected by AgBank's financial condition and results of operations. The AgBank and AgBank District quarterly and annual reports are available free of charge by accessing AgBank's website, [www.usagbank.com](http://www.usagbank.com), or may be obtained at no charge by contacting us at 3625 Citadel Drive South, Colorado Springs, Colorado 80909 or calling (800) 815-8559. Annual reports are available within 75 days after year end and quarterly reports are available within 40 days after the calendar quarter end.

In November of 2010, the AgBank Board of Directors voted to pursue a merger with CoBank, another Farm Credit System Bank. The proposed merger is targeted to be effective on October 1, 2011. We do not expect there to be any material negative impact to its operations as a result of the merger.

We purchase technology and other operational services from AgVantis, which is a technology service corporation. Our current Services Agreement with AgVantis expires on December 31, 2011. We are a shareholder in AgVantis, along with all other AgVantis customers. Farm Credit Foundations, a human resource service provider for a number of Farm Credit institutions, provides our payroll and human resource services.

## **ECONOMIC OVERVIEW**

For many years, agriculture experienced a sustained period of favorable economic conditions due to strong commodity prices, rising land values, and, to a lesser extent, government support and multi-peril insurance programs. Because of this overall prosperity, our financial results were positively impacted. Production agriculture, however, is a cyclical business that is heavily influenced by commodity prices. In the past 2 ½ years, conditions in the general economy and agricultural economy have been less favorable with the recent instability in the global markets and volatility in production costs. Particularly affected has been dairy, timber, land in transition, and biofuel operations. The negative impact to us from these less favorable conditions is somewhat lessened by geographic and commodity diversification and the generally strong financial condition of our agricultural borrowers. Some borrowers who are reliant on off-farm income sources have also been more adversely impacted due to the weakened general economy.

During 2010, economic conditions in our region were favorable for most of the farm and ranch operators. In general, our territory received abundant moisture during the spring, which resulted in record breaking yields for many wheat and corn producers. In addition to the strong crop yields, prices of grain spiked due to tight supplies worldwide, and potato prices more than doubled from 2009 levels, all of which will result in improved margins for producers despite higher input costs. Conversely, the volatility in the grain prices will adversely impact livestock producers in 2011 due to higher feed costs.

An extremely dry weather pattern beginning in late summer and continuing through fall and early winter has caused the majority of our territory to be classified by the National Weather Service as “abnormally dry” to “moderate drought”. These conditions are a major concern for the fall planted dry land wheat crop and pose potential adverse impact for both spring planted grain and pasture conditions with predictions for the dry pattern to continue or intensify. Despite the dry conditions east of the Rockies, the National Resources Conservation Service reports average to above average snow pack conditions for most of the State of Colorado raising the prospect of an adequate water supply for irrigators in our territory.

Real estate prices continue to be stable for agricultural property in our territory, although significant declines in values have been noted on properties which have non-farm influence along the Colorado Front Range, as well as recreational properties, which is the result of the soft general economy.

## **LOAN PORTFOLIO**

Total loan volume was \$745.5 million at December 31, 2010, an increase of \$11.0 million, or 1.50%, from loans at December 31, 2009 of \$734.5 million, and an increase of \$5.9 million, or 0.80%, from loans at December 31, 2008 of \$739.6 million. The increase in loans was due to marketing efforts to new and existing customers. The types of loans outstanding at December 31 are reflected in the following table.

<i>(dollars in thousands)</i>	2010		2009		2008	
	Volume	Percent	Volume	Percent	Volume	Percent
Real estate mortgage loans	\$ 427,422	57.3%	\$ 423,257	57.6%	\$ 392,271	53.0%
Production and intermediate-term loans	167,528	22.5%	155,177	21.1%	142,604	19.3%
Agribusiness loans to:						
Cooperatives	22,371	3.0%	10,124	1.4%	8,710	1.2%
Process and marketing	63,966	8.6%	79,932	10.9%	120,222	16.2%
Farm related business	12,843	1.7%	16,225	2.2%	19,857	2.7%
Communication loans	21,507	2.9%	16,660	2.3%	29,652	4.0%
Energy loans	19,038	2.5%	24,011	3.3%	19,047	2.6%
International loans	10,215	1.4%	8,413	1.1%	6,417	0.9%
Rural residential real estate loans	620	0.1%	721	0.1%	817	0.1%
<b>Total</b>	<b>\$ 745,510</b>	<b>100.0%</b>	<b>\$ 734,520</b>	<b>100.0%</b>	<b>\$ 739,597</b>	<b>100.0%</b>

Real estate mortgage volume increased to \$427.4 million, compared with \$423.3 million at year-end 2009. Long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from 5 to 40 years. Real estate mortgage loans are also made to rural homeowners. By federal regulation, a real estate mortgage loan must be secured by a first lien and may only be made in an amount up to 85% of the original appraised value of the property, or up to 97% of the appraised value, if the loan is guaranteed by certain state, federal, or other governmental agencies.

The production and intermediate-term volume increased 7.96% to \$167.5 million, compared with 2009 loan volume of \$155.2 million. In addition to marketing efforts, volume increased due to participation interests purchased. Production loans are used to finance the ongoing operating needs of agricultural producers. Production loans generally match the borrower's normal production and marketing cycle, which is typically 12 months. Intermediate-term loans are generally used to finance depreciable capital assets of a farm or ranch. Intermediate-term loans are written for a specific term, 1 to 15 years, with most loans being less than 10 years.

Decreases were noted in agribusiness and energy loan volume while communication and international loan volume increased. The majority of agribusiness and all communication, energy and international loan volume is purchased interests in loans. At December 31, 2010, 16.48% of real estate mortgage volume and 15.14% of production and intermediate-term loan volume were purchased interests in loans. Total participation purchased loans decreased \$12.1 million or 4.87% compared with 2009 year-end volume and represent 31.70% of the year-end 2010 outstanding loan volume.

### **Portfolio Diversification**

While we make loans and provide financially related services to qualified borrowers in agricultural and rural sectors and to certain related entities, our loan portfolio is diversified by participations purchased and sold, geographic locations served and commodities financed, as illustrated in the following three tables.

We purchase participation interests in loans from other System and non-System entities to generate additional earnings and diversify risk related to existing commodities financed and our geographic area served. In addition, we sell a portion of certain large loans to other System and non-System entities to reduce risk and comply with lending limits we have established.

To increase our participations, we are a party to a shared lending operation known as the Agribusiness Finance Group (AFG). The agreement includes our association, Farm Credit Services of the Mountain Plains, ACA, Premier Farm Credit, ACA, and Farm Credit of New Mexico, ACA. Along with these associations, we pool our resources to coordinate and enhance the marketing, originating and servicing of large, complex commercial and mortgage loans, as well as diversify risk. An agreement has been signed to terminate the AFG on September 1, 2011.

To increase our market share of broadly syndicated participation loans, we are a party to a shared lending operation known as the Commercial Finance Group (CFG). The agreement includes our Association together with Premier Farm Credit, ACA, Farm Credit Services of East Central Oklahoma, ACA; United FCS, ACA; AgCountry Farm Credit Services, ACA; Farm Credit Services of North Dakota, ACA; Farm Credit Services of Mandan, ACA; and Farm Credit Services of Western Arkansas, ACA. Along with these associations, we pool our resources to coordinate and enhance the marketing, originating and servicing of large, complex commercial and mortgage loans, as well as diversify risk. This agreement was consummated December 2010.

Our volume of participations purchased and sold as of December 31 follows.

<i>(dollars in thousands)</i>	<b>2010</b>	2009	2008
Participations purchased with AFG	<b>\$ 200,646</b>	\$ 210,403	\$ 249,232
Participations purchased with CFG	<b>3,891</b>	–	–
Participations purchased with other Farm Credit institutions	<b>\$ 29,014</b>	\$ 35,851	\$ 38,633
Participations purchased with non-Farm Credit institutions	<b>2,766</b>	2,148	–
<b>Total participations purchased</b>	<b>\$ 236,317</b>	\$ 248,402	\$ 287,865
Participations sold to AFG	–	–	540
Participations sold to other Farm Credit institutions	<b>\$ 16,397</b>	\$ 23,178	\$ 18,896
Participations sold to non-Farm Credit institutions	<b>1,000</b>	–	–
<b>Total participations sold</b>	<b>\$ 17,397</b>	\$ 23,178	\$ 19,436

We have no loans sold with recourse, retained subordinated participation interests in loans sold or interests in pools of subordinated participation interests that are held in lieu of retaining a subordinated participation interest in the loans sold.

The geographic distribution of loans by county at December 31 follows. As previously mentioned we purchase loans outside our territory, which are included in Other in the following table.

	2010	2009	2008
Adams	1.39%	1.49%	1.54%
Alamosa	2.54%	1.53%	1.26%
Arapahoe	2.49%	3.47%	3.17%
Archuleta	0.08%	0.90%	0.93%
Baca	1.90%	1.90%	1.73%
Bent	1.50%	1.51%	1.48%
Cheyenne	3.13%	2.57%	2.26%
Conejos	0.97%	0.94%	1.01%
Douglas	2.56%	2.53%	2.56%
El Paso	1.77%	1.88%	2.68%
Elbert	3.27%	3.38%	3.39%
Fremont	2.14%	1.28%	1.13%
Jefferson	0.56%	1.15%	1.14%
Kiowa	2.01%	2.00%	1.45%
Kit Carson	16.50%	15.85%	15.40%
Las Animas	1.21%	1.09%	1.03%
Lincoln	4.56%	5.03%	4.72%
Otero	2.95%	0.79%	2.13%
Prowers	3.30%	2.50%	2.55%
Pueblo	1.68%	0.04%	2.51%
Rio Grande	2.50%	0.46%	2.51%
Saguache	2.63%	2.67%	3.16%
Other – Colorado	9.31%	16.88%	9.40%
Other	29.05%	28.16%	30.86%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

We are party to a Territorial Concurrence Agreement (Agreement) with other associations in the states of Oklahoma, Colorado, Kansas and New Mexico. The Agreement eliminates territorial restrictions and allows associations that are a party to the Agreement to make loans in any other association's territory regardless of a borrower's place of residence, location of operations, location of loan security or location of a headquarters. This Agreement can be terminated upon the earlier to occur of:

- 1) the time when all but one association has withdrawn as a party to the Agreement; or
- 2) December 31, 2025, or
- 3) when requested by FCA.

We are a party to an Agreement Providing Territorial Concurrence (Agreement) with Farm Credit Services of America. This Agreement eliminates territorial restrictions and allows them to make loans in our territory through its dealer network.

The following table shows the primary agricultural commodities produced by our borrowers based on the Standard Industrial Classification System (SIC) published by the federal government. This system is used to assign commodity or industry categories based on the primary business of the customer. A primary business category is assigned when the commodity or industry accounts for 50% or more of the total value of sales for a business; however, a large percentage of agricultural operations typically includes more than one commodity.

SIC Category	December 31		
	2010	2009	2008
Cattle	22.45%	22.40%	22.39%
Wheat	17.19%	17.53%	14.20%
Corn	9.15%	8.87%	8.82%
Timber	5.98%	6.07%	6.93%
Hay	5.90%	5.38%	5.09%
Potatoes	5.57%	5.19%	4.82%
Other	33.76%	34.56%	37.75%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Our loan portfolio contains a concentration of cattle and wheat producers. Cattle producers consists of three sub-categories: fed cattle, grazing stockers and cow/calf producers. Each has distinct risk profiles which provides for additional diversity. As of December 31, 2010, borrowers with fed cattle as their primary product comprised 5.18% of

the portfolio, grazing stockers were 5.49% and cow/calf producers were 11.78%. Our concentration in wheat producers declined from 17.53% at December 31, 2009 to 17.19% as of December 31, 2010, but is still above December 31, 2008 when wheat producers comprised 14.20% of our portfolio.

Repayment ability of our borrowers is closely related to the production and profitability of the commodities they raise. If a loan fails to perform, restructuring and/or other servicing alternatives are influenced by the underlying value of the collateral which is impacted by industry economics. Our future performance would be negatively impacted by adverse agricultural conditions. The degree of the adverse impact would be correlated to the commodities negatively affected and the magnitude and duration of the adverse agricultural conditions to our borrowers.

In addition to commodity diversification noted in the previous table, further diversification is also achieved from loans to rural residents and part-time farmers which typically derive most of their earnings from non-agricultural sources. These borrowers are less subject to agricultural cycles and would likely be more affected by weaknesses in the general economy. Of our loan volume at December 31, 2010, 16.40% consists of borrowers that are non-farm income dependent, an increase from 15.40% for 2009 and 13.50% for 2008.

The principal balance outstanding at December 31, 2010 for loans less than \$250 thousand accounted for 21.27% of loan volume and 76.61% of the number of loans. Credit risk on small loans, in many instances, may be reduced by non-farm income sources. The table below details loan principal by dollar size at December 31.

<i>(dollars in thousands)</i>	2010		2009		2008	
	Amount outstanding	Number of loans	Amount outstanding	Number of loans	Amount outstanding	Number of loans
\$1 - \$250	\$ 158,564	2,175	\$ 154,078	2,089	\$ 154,794	2,087
\$251 - \$500	112,082	321	108,344	310	97,439	278
\$501 - \$1,000	125,208	180	123,535	173	112,973	159
\$1,001 - \$5,000	296,727	154	278,201	146	308,823	155
\$5,001 - \$25,000	52,929	9	70,362	12	65,568	11
Total	\$ 745,510	2,839	\$ 734,520	2,730	\$ 739,597	2,690

Approximately 9.50% of our loan volume is attributable to 10 borrowers. Due to their size, the loss of any of these loans or the failure of any of these loans to perform would adversely affect the portfolio and our future operating results.

Credit guarantees with government agencies of \$12.3 million at year-end 2010, \$9.6 million at year-end 2009 and \$7.2 million at year-end 2008 were outstanding.

### **Credit Commitments**

We may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of our borrowers and to manage our exposure to interest rate risk. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in our consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. We may also participate in standby letters of credit to satisfy the financing needs of our borrowers. These standby letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. The following table summarizes the maturity distribution of unfunded credit commitments on loans at December 31, 2010.

<i>(dollars in thousands)</i>	Less than 1 year	1 – 3 years	3 – 5 years	Over 5 years	Total
Commitments to extend credit	\$ 60,971	\$ 75,511	\$ 28,216	\$ 6,453	\$171,151
Standby letters of credit	3,902	370	6	181	4,459
Total commitments	\$ 64,873	\$ 75,881	\$ 28,222	\$ 6,634	\$175,610

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the consolidated Statement of Condition until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and we apply the same credit policies to these commitments. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on our credit evaluation of the borrower. No material losses are anticipated as a result of these credit commitments.

**High Risk Assets**

Nonperforming loan volume is comprised of nonaccrual loans, restructured loans, and loans 90 days past due still accruing interest and are referred to as impaired loans. High risk assets consist of impaired loans and other property owned. Comparative information regarding high risk assets in the portfolio, including accrued interest, follows:

<i>(dollars in thousands)</i>	2010	2009	2008
Nonaccrual loans:			
Real estate mortgage	\$ 9,798	\$ 6,718	\$ 6,548
Production and intermediate-term	1,835	181	4,593
Agribusiness	2,337	3,336	2,896
Communication	–	891	–
Total nonaccrual loans	13,970	11,126	14,037
Accruing restructured loans:			
Real estate mortgage	4	5	109
Accruing 90 days past due:			
Real estate mortgage	–	–	4,210
Production and intermediate-term	–	–	15
Total accruing loans 90 days past due	–	–	4,225
Total impaired loans	13,974	11,131	18,371
Other property owned	1,812	3,003	–
Total high risk assets	\$ 15,786	\$ 14,134	\$ 18,371
Nonaccrual loans to total loans	1.87%	1.51%	1.90%
Impaired loans to total loans	1.87%	1.52%	2.48%
High risk assets to total loans	2.12%	1.92%	2.48%
High risk assets to total shareholders' equity	9.32%	8.84%	11.73%

Total high risk assets increased \$1.7 million, or 11.69%, to \$15.8 million at December 31, 2010 compared with year-end 2009. Contributing to the increase in our high risk assets were loans to borrowers adversely impacted by commodity price volatility, higher farm input costs and the deterioration in the general economy.

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of all principal and/or interest. Nonaccrual volume increased \$2.8 million compared with December 31, 2009. Seven loans to five customers were transferred to nonaccrual status during 2010 causing the increase in the real estate mortgage and production and intermediate-term nonaccrual loans. Nonaccrual agribusiness loans decreased from 2009 primarily due to \$1.1 million in charge-offs recorded on an agribusiness participation loan. This customer is in the biodiesel industry and the charge-offs were the result of a reduction in the net realizable value of the collateral. Three participation purchased loans to two borrowers were sold during 2010 eliminating our communication nonaccrual volume as of December 31, 2010 compared to \$891 thousand at December 31, 2009. Six customers comprise approximately 92% of total nonaccrual volume. The following table provides additional information on nonaccrual loans as of December 31.

<i>(dollars in thousands)</i>	2010	2009	2008
Nonaccrual loans current as to principal and interest	\$ 5,295	\$ 831	\$ 4,683

For the years presented, we had no cash basis nonaccrual loans or no restructured loans in nonaccrual status.

Accruing restructured loans including related accrued interest decreased \$1 thousand during 2010 as a result of repayments. The restructured loans include only the year-end balances of loans and related accrued interest on which monetary concessions have been granted to borrowers and that are in accrual status. Restructured loans do not include loans on which extensions or other non-monetary concessions have been granted, or restructured loans on which monetary concessions have been granted but which remain in nonaccrual status.

Other property owned is real or personal property that has been acquired through foreclosure, deed in lieu of foreclosure or other means. We had other property owned of \$1.8 million at December 31, 2010, compared with \$3.0 million at December 31, 2009 resulting from the foreclosure of real estate that was secured for one borrower. This property was reevaluated in the fourth quarter 2010. The value decreased due to a reduction in the market value of the property with a \$1.2 million write-down recorded to losses on other property owned.

High risk asset volume is anticipated to remain flat for 2011 and then slowly decrease over the following few years due to the time it will take to work through the existing nonaccrual loans and due to the sluggish general economy.

**Credit Quality**

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System (UCS), which is used by all System institutions. Below are the classification definitions.

- 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 as substandard assets. However, doubtful assets have additional weaknesses in existing facts that make collection in full highly questionable.
- Loss – Assets are not considered collectible.

The following table presents statistics based on UCS related to the credit quality of the loan portfolio, including accrued interest at December 31.

	2010	2009	2008
Acceptable	85.53%	88.20%	91.50%
OAEM	9.15%	7.48%	4.14%
Substandard	5.08%	4.32%	4.36%
Doubtful	0.24%	–	–
Total	100.00%	100.00%	100.00%

Recent economic conditions have created challenges for some borrowers and our credit quality has declined. Loans classified as “Acceptable” and “OAEM” were 94.68% at December 31, 2010 and 95.68% at December 31, 2009. We had 0.24% of our loans classified as “Doubtful” at December 31, 2010. Doubtful volume was in the biodiesel industry. We had no loans classified as “Loss” for any of the three years presented. With our borrowers’ generally strong financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio remains strong. Agriculture remains a cyclical business that is heavily influenced by production, operating costs and commodity prices. Each of these can be significantly impacted by uncontrollable events. While credit quality is anticipated to remain sound in 2011, we expect that the less favorable economic conditions and less government support programs may lead to further weakening in the loan portfolio. Loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans decreased and remained at a low level of 0.35% at December 31, 2010, compared with 0.73% at December 31, 2009.

**Allowance for Loan Losses**

We maintain an allowance for loan losses at a level consistent with the probable losses identified by management. The allowance for loan losses at each period end was considered to be adequate to absorb probable losses existing in the loan portfolio. Because the allowance for loan losses considers factors such as current agricultural and economic conditions, loan loss experience, portfolio quality and loan portfolio composition, there will be a direct impact to the allowance for loan losses and our income statement when there is a change in any of those factors. The following table provides relevant information regarding the allowance for loan losses as of December 31.

<i>(dollars in thousands)</i>	2010	2009	2008
Balance at beginning of year	\$ 3,401	\$ 2,588	\$ 2,621
Charge-offs:			
Real estate mortgage	–	33	–
Production and intermediate-term	95	52	–
Agribusiness	1,110	945	7
Communication	42	650	55
Total charge-offs	1,247	1,680	62
Recoveries:			
Production and intermediate-term	1	–	9
Communication	33	–	–
Total recoveries	34	–	9
Net charge-offs	1,213	1,680	53
Provision for loan losses	1,518	2,493	20
Balance at December 31	\$ 3,706	\$ 3,401	\$ 2,588
Net charge-offs to average net loans	0.17%	0.23%	0.01%

The following table presents the allowance for loan losses by loan type as of December 31.

<i>(dollars in thousands)</i>	2010	2009	2008
Real estate mortgage	\$ 796	\$ 741	\$ 614
Production and intermediate-term	845	1,182	1,035
Agribusiness	1,844	1,355	781
Communication	56	43	82
Energy	160	63	76
International	5	17	–
Total	\$ 3,706	\$ 3,401	\$ 2,588

The allowance for loan losses increased \$305 thousand from December 31, 2009, to \$3.7 million at December 31, 2010. Given the continued volatility and uncertainty in the general economy, extreme volatility in commodity markets and declining real estate values along the Front Range of Colorado, we believe the overall risk profile of our loan portfolio has increased. Accordingly, the allowance for loan losses has been adjusted to reflect this increased risk.

The increase in allowance for loan losses was primarily due to the provision for loan losses totaling \$1.5 million that was recorded due to net charge-offs. Net charge-offs of \$1.2 million were recorded during 2010. Charge-offs were recorded on four loan complexes during 2010 with \$1.1 million of the charge-offs, or 82.60%, being from one participation purchased loan complex in the biodiesel industry. Overall, charge-off activity remains low relative to the size of our loan portfolio. Comparative allowance for loan losses coverage as a percentage of loans and certain other credit quality indicators as of December 31 are presented in the following table.

	2010	2009	2008
Allowance as a percentage of:			
Loans	0.50%	0.46%	0.35%
Impaired loans	26.52%	30.55%	14.09%
Nonaccrual loans	26.53%	30.57%	18.44%

#### **Young, Beginning and Small Farmers and Ranchers Program**

As part of the Farm Credit System, we are committed to providing sound and dependable credit and related services to young, beginning and small (YBS) farmers and ranchers. We have a strong belief that the future of agriculture and the future of our organization are dependent on the success of Young, Beginning and Small farmers and ranchers. We will provide lending products, financial services, training opportunities, sponsorships and staff expertise to YBS farmers and ranchers. The FCA regulatory definitions for YBS farmers and ranchers are shown below.

- Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.
- Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who had 10 years or less farming or ranching experience as of the date the loan was originally made.
- Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generated less than \$250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The following table outlines our percentage of YBS loans as a percentage of the number of loans in our loan portfolio while the USDA column represents the percent of farmers and ranchers classified as YBS within our territory per the 2007 USDA Agricultural Census, which is the most current data available. Due to FCA regulatory definitions, a loan may be included in multiple categories as each would be included in each category in which the definition was met.

	USDA	2010	2009	2008
Young	9.23%	16.50%	16.10%	15.76%
Beginning	35.68%	17.32%	17.77%	18.05%
Small	91.34%	41.39%	41.43%	43.73%

We establish annual marketing goals to increase market share of loans to YBS farmers and ranchers. Our goals are as follows:

- Offer related services either directly or in coordination with others that are responsive to the needs of YBS farmers and ranchers in our territory;
- Take full advantage of opportunities for coordinating credit and services offered with other System institutions in the territory and other governmental and private sources of credit who offer credit and services to those who qualify as YBS farmers and ranchers in our territory; and,
- Implement effective outreach programs to attract YBS farmers and ranchers.

As part of our marketing strategy we utilize USDA and other loan guarantee programs whenever it is advantageous to a YBS customer. During 2010, we sponsored several educational programs that target YBS farmers and ranchers. We also sponsor numerous leadership development activities for agricultural organizations. In addition to the sponsorships, we provide computer resources to various Future Farmers of America (FFA) organizations in our territory. For 2011, we have established the following qualitative goals:

- Distribute six or more used computers to area FFA Chapters;
- Sponsor YBS Focus groups to provide insight and feedback into how to better serve this market segment;
- Have ten to twelve Colorado State University students from the College of Agriculture participate in the Student Board program each semester.

Quarterly reports are provided to our Board of Directors detailing the number, volume and credit quality of our YBS customers. We have developed quantitative targets to monitor our progress. The following table reflects the quantitative objectives and results for YBS lending we have established.

2010 YBS quantitative objectives results follow.

<b>New Loans</b>	<b>Number Goal</b>	<b>Number Results</b>	<b>Volume Goal</b>	<b>Volume Results</b>
Young	40	32	\$ 7,250	\$ 5,343
Beginning	47	34	\$ 15,300	\$ 10,735
Small	64	62	\$ 12,600	\$ 14,757
<b>Existing Loans</b>				
Young	500	506	\$ 83,000	\$ 90,300
Beginning	550	531	\$ 140,000	\$ 130,761
Small	1265	1269	\$ 140,000	\$ 147,170

2011 YBS quantitative objectives follow.

<b>New Loans</b>	<b>Number Goal</b>	<b>Volume Goal</b>
Young	42	\$ 7,500
Beginning	49	\$ 15,750
Small	64	\$ 15,000
<b>Existing Loans</b>		
Young	520	\$ 92,500
Beginning	546	\$ 134,000
Small	1300	\$ 151,000

In addition to the objectives outlined above, we have a goal of making 60 new YBS loans to new customers for \$20.0 million and a goal of four Farm Service Agency or other guaranteed loans for \$1.0 million in volume. We have committed \$3.0 million of capital to fund loans to YBS farmers and ranchers.

To ensure that credit and services offered to our YBS farmers and ranchers are provided in a safe and sound manner and within our risk-bearing capacity, we utilize customized loan underwriting standards, loan guarantee programs, or other credit enhancement programs. Additionally, we are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

### **CREDIT RISK MANAGEMENT**

Credit risk arises from the potential failure of a borrower to meet repayment obligations that result in a financial loss to the lender. Credit risk exists in our loan portfolio and also in our unfunded loan commitments and standby letters of credit. Credit risk is actively managed on an individual and portfolio basis through application of sound lending and underwriting standards, policies and procedures.

Underwriting standards are utilized to determine an applicant's operational, financial, and managerial resources available for repaying debt within the terms of the note and loan agreement. Underwriting standards include among other things, an evaluation of:

- character – borrower integrity and credit history;
- capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income;
- collateral – to protect the lender in the event of default and also serve as a secondary source of loan repayment;
- capital – ability of the operation to survive unanticipated risks; and,
- conditions – intended use of the loan funds, terms, restrictions, etc.

Processes for information gathering, balance sheet and income statement verification, loan analysis, credit approvals, disbursements of proceeds and subsequent loan servicing actions are established and followed. Underwriting standards vary by industry and are updated periodically to reflect market and industry conditions.

By regulation, we cannot have loan commitments to one borrower for more than 25% of our permanent capital. Through lending delegations, AgBank restricts individual loan size limits to one borrower to 15% of our permanent capital; exceptions must be reported to AgBank. Within these parameters, we set our own lending limits to manage loan concentration risk. Lending limits are established on a loan by loan basis for all customer complexes that exceed 5% of permanent capital. We utilize a tool that considers such factors as financial position, financial statement quality, enterprise concentrations and collateral. We have adopted an individual lending limit maximum of 10% of permanent capital for our highest quality borrowers.

We have established internal lending delegations to properly control the loan approval process. Delegations to staff are based on our risk-bearing ability, loan size, complexity, type and risk, as well as the expertise and position of the credit staff member. Larger and more complex loans or loans perceived to have higher risk are typically approved by the most experienced and knowledgeable credit staff members.

The majority of our lending is first mortgage real estate loans which must be secured by a first lien on real estate. Production and intermediate-term lending accounts for most of the remaining volume and is also typically secured. Collateral evaluations are completed in compliance with FCA and Uniform Standards of Professional Appraisal Practices requirements. All property is appraised at market value. All collateral evaluations must be performed by a qualified appraiser. Certain appraisals must be performed by individuals with a state certification or license.

We use a two-dimensional risk rating model (Model) based on the Farm Credit System's Combined System Risk Rating Guidance which estimates each loan's probability of default (PD) and loss given default (LGD). PD estimates the probability that a borrower will experience a default within twelve months from the date of determination. LGD provides an estimation of the anticipated loss with respect to a specific financial obligation of a borrower assuming a default has occurred or will occur within the next twelve months. The Model uses objective and subjective criteria to identify inherent strengths, weaknesses, and risks in each loan. The PDs and LGDs are utilized in loan and portfolio management processes and are partially utilized for the allowance for loan losses estimate. This Model also serves as the basis for economic capital modeling.

The Model's 14-point probability of default scale provides for nine acceptable categories, one OAEM category, two substandard categories, one doubtful category and one loss category; each carrying a distinct percentage of default probability. The Model's LGD scale provides 6 categories that have the following anticipated principal loss and range of economic loss expectations:

- A 0% anticipated principal loss; 0% to 5% range of economic loss
- B 0% to 3% anticipated principal loss; 5% to 15% range of economic loss
- C > 3% to 7% anticipated principal loss; 15% to 20% range of economic loss
- D > 7% to 15% anticipated principal loss; 20% to 25% range of economic loss
- E > 15% to 40% anticipated principal loss; 25% to 50% range of economic loss
- F above 40% anticipated loss; above 50% range of economic loss

**RESULTS OF OPERATIONS****Earnings Summary**

In 2010, we recorded net income of \$10.5 million, compared with \$5.3 million in 2009, and \$13.2 million in 2008. The increase in 2010 was primarily due to decreased provision for loan losses and noninterest expense and an increase in noninterest income. The following table presents the changes in the significant components of net income from the previous year.

<i>(dollars in thousands)</i>	<b>2010 vs. 2009</b>	2009 vs. 2008
Net income, prior year	<b>\$ 5,303</b>	\$ 13,226
Increase/(Decrease) from changes in:		
Interest income	<b>(1,031)</b>	(4,496)
Interest expense	<b>1,985</b>	3,974
Net interest income	<b>954</b>	(522)
Provision for loan losses	<b>975</b>	(2,473)
Noninterest income	<b>1,135</b>	(2,251)
Noninterest expense	<b>2,197</b>	(2,702)
Provision for income taxes	<b>(58)</b>	25
Total increase/(decrease) in net income	<b>5,203</b>	(7,923)
Net income, current year	<b>\$ 10,506</b>	\$ 5,303

Return on average assets increased to 1.38% from 0.68% in 2009 due to increased net income and lower average assets. Return on average shareholders' equity increased to 6.25% from 3.31% in 2009 primarily as a result of increased net income.

**Net Interest Income**

Net interest income for 2010 was \$19.5 million compared with \$18.5 million for 2009 and \$19.1 million for 2008. Net interest income is our principal source of earnings and is impacted by interest earning asset volume, yields on assets and cost of debt. The increase in net interest income was largely due to an increase in our interest rate spread. The table below provides an analysis of the individual components of the change in net interest income during 2010 and 2009.

<i>(dollars in thousands)</i>	<b>2010 vs. 2009</b>	2009 vs. 2008
Net interest income, prior year	<b>\$ 18,534</b>	\$ 19,056
Increase/(Decrease) in net interest income from changes in:		
Interest rates earned	<b>(239)</b>	(6,291)
Interest rates paid	<b>1,338</b>	4,994
Volume of interest-bearing assets and liabilities	<b>(158)</b>	484
Interest income on nonaccrual loans, current year	<b>13</b>	291
Increase/(Decrease) in net interest income	<b>954</b>	(522)
Net interest income, current year	<b>\$ 19,488</b>	\$ 18,534

The following table illustrates net interest margin and the average interest rates on loans and debt cost and interest rate spread.

	<b>For the Year Ended December 31</b>		
	<b>2010</b>	2009	2008
Net interest margin	<b>2.69%</b>	2.50%	2.67%
Interest rate on:			
Average loan volume	<b>5.36%</b>	5.39%	6.23%
Average debt	<b>3.31%</b>	3.53%	4.39%
Interest rate spread	<b>2.05%</b>	1.86%	1.84%

The increase in interest rate spread of 19 basis points resulted from a 3 basis point decrease in interest rates on average loan volume and a 22 basis point decrease in interest rates on average debt. The market conditions and competitive environment in 2010 allowed us to increase the interest rate spread, particularly on our fixed rate products and in our participation purchased portfolio. The increase in spread was achieved despite an increase charged by AgBank of 10 basis points effective July 1, 2009 and another 10 basis points effective January 1, 2010

through September 30, 2010. Net interest margin increased 19 basis points over 2009 due to the change in spread with minimal impact from lower earnings on our own capital.

### **Provision for Loan Losses**

We monitor our loan portfolio on a regular basis to determine if any increase through provision for loan losses or decrease through a loan loss reversal in our allowance for loan losses is warranted based on our assessment of the probable losses in our loan portfolio. We recorded net provision for loan losses of \$1.5 million in 2010, compared with \$2.5 million in 2009 and \$20 thousand in 2008. The provision for loan losses recorded during 2010 was primarily due to recorded charge-offs and increased risk exposure on certain loans. The provision for loan losses recorded in 2009 was primarily due to increased risk exposure on certain loans due to the unprecedented volatility and uncertainty in the general economy and in various sectors of the agricultural industry, including meat, protein, timber and ethanol sectors.

### **Noninterest Income**

During 2010, we recorded noninterest income of \$2.7 million, compared with \$1.6 million in 2009 and \$3.8 million in 2008. Patronage distributions from AgBank are our primary source of noninterest income. Beginning in 2009, patronage from AgBank was determined annually instead of quarterly and, except for certain priority patronage, paid after the end of the year. As a result, our patronage income increased in 2010, compared with 2009 where only priority patronage was paid. Patronage received was \$1.1 million in 2010, \$322 thousand in 2009, and \$2.9 million in 2008. AgBank patronage was paid in cash. Patronage received from CoBank was \$22 thousand in 2010, \$20 thousand in 2009 and \$35 thousand in 2008. CoBank patronage was paid in stock. During 2010, we received from Farm Credit System Insurance Company (FCSIC) a distribution of \$775 thousand representing our allocated portion of the excess amount in the System's insurance fund above the 2% secure base amount. As a result, our noninterest income increased compared with 2009. Noninterest income also includes loan fees, financially related services income and other noninterest income. Loan fees in 2010 were \$555 thousand, a decrease of \$451 thousand from 2009, primarily due to a decrease in fees earned on our participation purchased portfolio.

### **Noninterest Expense**

Noninterest expense for 2010 decreased \$2.2 million, or 17.83%, to \$10.1 million compared with 2009. Noninterest expense for each of the three years ended December 31 is summarized below:

<i>(dollars in thousands)</i>	<b>Percent of Change</b>				
	<b>2010</b>	2009	2008	<b>2010/2009</b>	2009/2008
Salaries & employee benefits	<b>\$ 5,719</b>	\$ 5,368	\$ 5,750	<b>6.54%</b>	(6.6%)
Occupancy & equipment	<b>462</b>	444	459	<b>4.05%</b>	(3.3%)
Purchased services from AgVantis	<b>649</b>	559	526	<b>16.10%</b>	6.3%
Supervisory & examination costs	<b>273</b>	251	230	<b>8.76%</b>	9.1%
Other	<b>1,500</b>	1,416	1,578	<b>5.93%</b>	(10.3%)
Total operating expense	<b>8,603</b>	8,038	8,543	<b>7.03%</b>	(5.9%)
Losses/(Gains) on other property owned	<b>1,197</b>	2,967	(26)	<b>(59.66%)</b>	NA
Farm Credit Insurance Fund premium	<b>325</b>	1,317	1,103	<b>(75.32%)</b>	19.4%
Total noninterest expense	<b>\$ 10,125</b>	\$ 12,322	\$ 9,620	<b>(17.83%)</b>	28.1%

For the year ended December 31, 2010, total operating expense increased \$565 thousand, or 7.03%, compared with the year ended December 31, 2009, primarily due to an increase in salaries and employee benefits and purchased services from AgVantis. Salaries and employee benefits increased primarily due to the implementation of a loan officer incentive program, as well as increases in pension and other retirement expenses. AgVantis increased the fees they charge for our data processing. Other expense increased primarily due to a one-time \$15 thousand fee paid to CFG to cover their costs related to the system setups needed to allow us to purchase participation interests in loans through them; a \$36 thousand increase in director's travel expense and a \$23 increase in purchased services; particularly related to temporary and contract employee costs; and advertising production costs.

Insurance Fund premium decreased \$992 thousand to \$325 thousand due to a decrease in the premium rate and a decrease in our average net note payable to AgBank. As of July 1, 2008, the FCSIC began charging premiums based on debt rather than loan volume. Rates were decreased to 5 basis points during 2010 compared with 20 basis points during 2009. Premium rates were 15 basis points on average loan volume during the first six months of 2008. During the last six months of 2008 premiums were charged on average debt at 15 basis points for the third quarter and 18 basis points for the fourth quarter.

In 2010, losses on other property owned of \$1.2 million were recorded for the write-down in the valuation of one property due to an appraisal completed during the fourth quarter of 2010. The 2009 loss was also caused by a write-down of the property for the appraisal that was completed in 2009.

### **Provision for income taxes**

We recorded \$62 thousand in provision for income taxes during 2010, compared with \$4 thousand in 2009 and \$29 thousand in 2008. The increase was primarily due to an increase in our taxable income and to a decrease in our deferred tax asset. Tax expense was also impacted by our patronage refund program. We operate as a Subchapter T cooperative for tax purposes and thus may deduct from taxable income certain amounts that are distributed from net earnings to borrowers. See Note 10 for additional details.

### **LIQUIDITY**

Liquidity is necessary to meet our financial obligations. Liquidity is needed to pay our note with AgBank, fund loans and other commitments, and fund business operations in a cost-effective manner. Our liquidity policy is intended to manage short-term cash flow, maximize debt reduction and liquidate nonearning assets. Our direct loan with AgBank, cash on hand and loan repayments provide adequate liquidity to fund our on-going operations and other commitments.

### **Funding Sources**

Our primary source of liquidity is the ability to obtain funds for our operations through a borrowing relationship with AgBank. Our note payable to AgBank is collateralized by a pledge to AgBank of substantially all of our assets. Substantially all cash received is applied to the note payable and all cash disbursements are drawn on the note payable. The indebtedness is governed by a General Financing Agreement (GFA). The GFA is subject to renewal at its expiration date of April 30, 2012 in accordance with normal business practices. We expect renewal of the GFA after the expiration date. The annual average principal balance of the note payable to AgBank was \$585.9 million in 2010, \$605.5 million in 2009 and \$575.1 million in 2008.

We plan to continue to fund lending operations through the utilization of our borrowing relationship with AgBank, retained earnings from current and prior years and from borrower stock investments. AgBank's primary source of funds is the ability to issue Systemwide Debt Securities to investors through the Federal Farm Credit Bank Funding Corporation. This access has traditionally provided a dependable source of competitively priced debt that is critical for supporting our mission of providing credit to agriculture and rural America. Although financial markets have experienced significant volatility in 2008 and 2009, we were able to obtain sufficient funding to meet the needs of our customers.

### **Interest Rate Risk**

The interest rate risk inherent in our loan portfolio is substantially mitigated through our funding relationship with AgBank which allows for loans to be match-funded. Borrowings from AgBank match the pricing, maturity, and option characteristics of our loans to borrowers. AgBank manages interest rate risk through the direct loan pricing and their asset/liability management processes. Although AgBank incurs and manages the primary sources of interest rate risk, we may still be exposed to interest rate risk through the impact of interest rate changes on earnings generated from our loanable funds. To stabilize earnings from loanable funds, we have committed excess funds with AgBank at a fixed rate as a part of AgBank's Earnings Stabilization Management Program (ESMP). This enables us to stabilize earnings without significantly increasing our overall interest rate risk position.

Our ESMP commitment balance and the average interest rate as of December 31 in the various maturities are reflected below:

<i>(dollars in thousands)</i>	2010		2009		2008	
	Balance	Average Rate	Balance	Average Rate	Balance	Average Rate
Maturing in 1 year or less	\$ 9,300	1.81%	\$ 13,000	1.27%	\$ 4,100	3.10%
Maturing in 1 to 3 years	—	—	6,300	2.19%	—	—
Total	\$ 9,300	1.81%	\$ 19,300	1.57%	\$ 4,100	3.10%

### **Funds Management**

We offer variable, fixed, adjustable prime-based and LIBOR-based rate loans to borrowers. Our Asset Liability Committee, with oversight from the Board of Directors, determines the interest rate charged based on the following factors: 1) the interest rate charged by AgBank; 2) our existing rates and spreads; 3) the competitive rate environment; and 4) our profitability objectives.

We have a relationship with CoBank and First Tennessee Bank to offer a purchase card program to commercial customers. The purchase cards are similar to credit cards and allow customers to make agricultural-related purchases which are then automatically posted to the customer's loan on a monthly basis. We remit payment to First Tennessee Bank each month for purchases made with the card.

## **CAPITAL RESOURCES**

Capital supports asset growth and provides protection for unexpected credit and operating losses. Capital is also needed for investments in new products and services. We believe a sound capital position is critical to our long-term financial success due to the volatility and cycles in agriculture. Over the past several years, we have been able to build capital primarily through net income retained after patronage. Shareholders' equity at December 31, 2010 totaled \$169.4 million, compared with \$160.0 million at December 31, 2009 and \$156.6 million at December 31, 2008. The increase of \$9.4 million in shareholder's equity reflects net income and net stock issuances, partially offset by patronage refunds and an increase in accumulated other comprehensive income. Our capital position is reflected in the following ratio comparisons.

	2010	2009	2008
Debt to shareholders' equity	3.61:1	3.85:1	3.96:1
Shareholders' equity as a percent of net loans	22.84%	21.88%	21.25%
Shareholders' equity as a percent of total assets	21.69%	20.63%	20.18%

Debt to shareholders' equity decreased and shareholders' equity as a percent of net loans and of total assets increased from 2009 primarily due to an increase in shareholders' equity due to net income increasing at a faster pace than net loans and total assets.

### ***Retained Earnings***

Our retained earnings increased \$7.9 million to \$156.1 million at December 31, 2010 from \$148.2 million at December 31, 2009. The increase was a result of net income of \$10.5 million, partially offset by \$2.5 million of patronage distributions declared and \$120 thousand in stock dividends.

### ***Patronage Program***

We have a Patronage Program that allows us to distribute our available net earnings to our shareholders. This program provides for the application of net earnings in the manner described in our Bylaws. In addition to determining the amount and method of patronage to be distributed, this includes increasing surplus to meet capital adequacy standards established by Regulations; increasing surplus to a level necessary to support competitive pricing at targeted earnings levels; and increasing surplus for reasonable reserves. Patronage distributions are based on business done with us during the year. We paid cash patronage of \$1.2 million in 2010, \$4.0 million in 2009 and \$6.0 million in 2008.

### ***Stock***

Our total stock increased \$1.3 million to \$13.2 million at December 31, 2010, from \$11.9 million at December 31, 2009. The increase was due to \$47.0 million of stock issuances, partially offset by \$45.7 million of stock retirements. We require a stock investment for each borrower. The current stock requirement for each borrower is the lesser of one thousand dollars or 2.00% of the collective total balance of each borrower's loan(s) depending on qualifications set by policy.

Preferred stock is a one cent, at-risk, investment stock that can only be purchased by owners of any class of common stock. Dividends are declared and paid at the discretion of the Board of Directors. Dividends are declared daily at a set investment rate and paid quarterly by purchase of additional preferred stock in the owner's name.

### ***Accumulated Other Comprehensive Income or Loss***

Accumulated other comprehensive income totaled \$158 thousand at December 31, 2010, an increase of \$268 thousand compared with year-end 2009. Certain employees participate in a non-qualified Defined Benefit Pension Restoration Plan (Plan). FASB guidance requires recognition of the Plan's underfunded status and unamortized actuarial gains and losses and prior service costs or credits as a liability with an offsetting adjustment to accumulated other comprehensive income.

### ***Capital Plan and Regulatory Requirements***

Our Board of Directors establishes a formal capital adequacy plan that addresses capital goals in relation to risks. The capital adequacy plan assesses the capital level necessary for financial viability and to provide for growth. Our

plan is updated annually and approved by our Board of Directors. FCA regulations require the plan consider the following factors in determining optimal capital levels, including:

- Regulatory capital requirements;
- Asset quality;
- Needs of our customer base; and
- Other risk-oriented activities, such as funding and interest rate risks, contingent and off-balance sheet liabilities and other conditions warranting additional capital.

FCA regulations establish minimum capital standards expressed as a ratio of capital to assets, taking into account relative risk factors for all System institutions. In general, the regulations provide for a relative risk weighting of assets and establish a minimum ratio of permanent capital, total surplus and core surplus to risk-weighted assets. Our capital ratios as of December 31 and the FCA minimum requirements follow.

	Regulatory Minimum	2010	2009	2008
Permanent capital ratio	7.00%	<b>19.85%</b>	17.94%	17.83%
Total surplus ratio	7.00%	<b>18.01%</b>	16.44%	16.19%
Core surplus ratio	3.50%	<b>17.58%</b>	16.44%	16.19%

As of December 31, 2010, we exceeded the regulatory minimum capital ratios and are expected to do so throughout 2011. However, the minimum ratios established were not meant to be adopted as the optimum capital level, so we have established goals in excess of the regulatory minimum. As of December 31, 2010, we have exceeded our goals. Due to our strong capital position, we will continue to be able to retire at-risk stock.

In June 2005, we transferred \$2.0 million of our excess investment in AgBank to AgBank's Excess Investment Priority Patronage Program. Under the terms of this program, the amount designated by an association is leveraged by AgBank in loans or investment securities for a term of up to two years. During that time, AgBank counted the designated amount as permanent capital and paid us an additional 50 basis points on the designated amount. Generally, we include our excess investment in AgBank as permanent capital, but exclude amounts transferred to this program from our permanent capital. At the conclusion of the capital counting term, April 30, 2010, the investment reverted back to us and is included in our permanent capital ratio once again.

### ***Building Projects***

We plan to construct a new administrative and branch lending office on land that was purchased in 2009. We are currently in the planning and design phase for the new building. As this time, we plan to begin construction in late spring 2011. The projected time to complete the construction is one year. The funding source for the new building will be from our capital.

### **REGULATORY MATTERS**

As of December 31, 2010, we had no enforcement actions in effect and FCA took no enforcement actions on us during the year.

The Farm Credit Administration is considering the promulgation of Tier 1 and Tier 2 capital standards for Farm Credit System institutions. The Tier 1/Tier 2 capital structure would be similar to the capital tiers delineated in the Basel Accord that the other Federal financial regulatory agencies have adopted for the banking organizations they regulate. Comments on the advance notice of proposed rulemaking are due in May 2011.

On June 16, 2008, the Farm Credit Administration published a proposed rule in the Federal Register that would authorize Banks, Associations or service corporations to invest in rural communities, i.e., communities that have fewer than 50,000 residents and are outside of an urbanized area, under certain conditions. The proposed rule would authorize two types of rural community investments: (1) investment in debt securities that would involve projects or programs that benefit the public in rural communities, and (2) equity investment in venture capital funds, which funds create economic opportunities and jobs in rural communities by providing capital to small or start-up businesses. Under the proposed rule, these investments would be limited to 150% of the institution's total surplus. The comment period closed August 15, 2008. A date for final action on the rule has not been determined.

## **GOVERNANCE**

### ***Board of Directors***

We are governed by a twelve member board that provides direction and oversees our management. Of these directors, 9 are elected by the shareholders and 3 are appointed by the elected directors. Our Board of Directors represents the interests of our shareholders. The Board of Directors meets regularly to perform the following functions, among others:

- selects, evaluates and compensates the chief executive officer;
- approves the strategic plan, capital plan, financial plan and the annual operating budget;
- oversees the lending operations;
- directs management on significant issues and,
- oversees the financial reporting process, communications with shareholders and our legal and regulatory compliance.

### ***Director Independence***

All directors must exercise sound judgment in deciding matters in our interest. All our directors are independent from the perspective that none of our management or staff serves as Board members. However, we are a financial services cooperative, and the Farm Credit Act and FCA Regulations require our elected directors to have a loan relationship with us.

The elected directors, as borrowers, have a vested interest in ensuring our Association remains strong and successful. However, our borrowing relationship could be viewed as having the potential to compromise the independence of an elected director. For this reason, the Board has established independence criteria to ensure that a loan relationship does not compromise the independence of our Board. Annually, in conjunction with our independence analysis and reporting on our loans to directors, each director provides financial information and any other documentation and/or assertions needed for the Board to determine the independence of each Board member.

### ***Audit Committee***

The Audit Committee reports to the Board of Directors. The Audit Committee is composed of six members. During 2010, 10 meetings were held. The Audit Committee responsibilities generally include, but are not limited to:

- oversight of the financial reporting risk and the accuracy of the quarterly and annual shareholder reports;
- the oversight of the system of internal controls related to the preparation of quarterly and annual shareholder reports;
- the review and assessment of the impact of accounting and auditing developments on the consolidated financial statements; and,
- the establishment and maintenance of procedures for the receipt, retention and treatment of confidential and anonymous submission of concerns, regarding accounting, internal accounting controls or auditing matters.

### ***Compensation Committee***

The Compensation Committee is responsible for the oversight of employee and director compensation, including annual CEO performance evaluation and base salary and incentive compensation recommendations. The Compensation Committee is composed of eight members. The Committee annually reviews, evaluates and approves the compensation policies, programs and plans for senior officers and employees including benefits programs.

### ***Other Governance***

The Board has monitored the requirements of public companies under the Sarbanes-Oxley Act. While we are not subject to the requirements of this law, we are striving to implement steps to strengthen governance and financial reporting. We strive to maintain strong governance and financial reporting through the following actions:

- a system for the receipt and treatment of whistleblower complaints,
- a code of ethics for our President/CEO, Chief Financial Officer and Chief Credit Officer,
- open lines of communication between the independent auditors, management, and the Audit Committee,
- "plain English" disclosures,
- officer certification of accuracy and completeness of the consolidated financial statements, and
- information disclosure through our website.

## **FORWARD-LOOKING INFORMATION**

Our discussion contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," and "will," or other variations of these terms are intended to identify

forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

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

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our consolidated financial statements are based on accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because we have to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2 of the accompanying consolidated financial statements. The development and selection of critical accounting policies, and the related disclosures, have been reviewed by our Audit Committee. A summary of critical policies relating to determination of the allowance for loan losses follows.

### **ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is our best estimate of the amount of probable loan losses existing in and inherent in our loan portfolio as of the balance sheet date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. We determine the allowance for loan losses based on a regular evaluation of the loan portfolio, which generally considers recent historic charge-off experience adjusted for relevant factors.

Loans are evaluated based on the borrower's overall financial condition, resources, and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors we consider in the evaluation of losses in the loan portfolio could occur for various credit related reasons and could result in a change in the allowance for loan losses, which would have a direct impact on the provision for loan losses and results of operations. See Notes 2 and 3 to the accompanying consolidated financial statements for detailed information regarding the allowance for loan losses.

### **CUSTOMER PRIVACY**

FCA regulations require that borrower information be held in confidence by Farm Credit institutions, their directors, officers and employees. FCA regulations and our Standards of Conduct Policies specifically restrict Farm Credit institution directors and employees from disclosing information not normally contained in published reports or press releases about the institution or its borrowers or members. These regulations also provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic information.

### **PATRON'S CONSENT TO TAKE PATRONAGE DISTRIBUTION INTO INCOME**

Our Bylaws under Section 735.6 states that each holder of our stock consents to take into account, as income, at its stated dollar amount as provided in 26 U.S.C. §1385, the amount of his or her respective distribution paid as a qualified written notice of allocation, which may include stock, allocated surplus, and/or the amount of any distribution that has been applied to the patron's indebtedness as provided in Section 735.4 and 735.5 of our Bylaws.

Consent under this section shall be continuing in effect, provided that consent pursuant to the first paragraph of this section shall cease to be effective with respect to patronage of a distributee occurring after the distributee has ceased to hold stock in us. Consent obtained under this section may be revoked in writing, provided that such revocation shall become effective only with respect to patronage occurring on or after the first day of our first fiscal year beginning after the revocation is filed with us.

## REPORT OF MANAGEMENT

The financial statements of Farm Credit of Southern Colorado, ACA (Association) are prepared by management, who is responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances, and in the opinion of management, fairly present the financial condition of the Association. Other financial information included in the 2010 annual report is consistent with that in the financial statements.

To meet its responsibility for reliable financial information, management depends on the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance assets are safeguarded and transactions are properly authorized and recorded. To monitor compliance, U.S. AgBank, FCB's Risk Management staff performs audits of the accounting records, reviews accounting systems and internal controls, and recommends improvements as appropriate. The financial statements are examined by PricewaterhouseCoopers LLP, independent auditors, who also conduct a review of internal controls to the extent necessary to comply with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The Audit Committee of the Board of Directors has overall responsibility for the Association's system of internal control and financial reporting. The Audit Committee consults regularly with management and reviews the results of the examinations by the various entities named above. The independent auditors have direct access to the Audit Committee.

The undersigned certify the Farm Credit of Southern Colorado, ACA Annual Report has been reviewed, 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 our knowledge and belief.



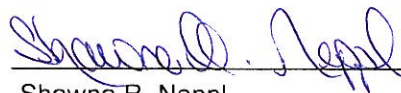
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Gary Pautler  
Chairman of the Board



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Russell Tomky  
President and Chief Executive Officer



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Shawna R. Nepl  
Chief Financial Officer

March 16, 2011

## AUDIT COMMITTEE REPORT

The Audit Committee (Committee) includes six members from the Board of Directors of Farm Credit of Southern Colorado, ACA (Association). In 2010, ten Committee meetings were held. The Committee oversees the scope of the Association's internal audit program, the independence of the outside auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter. The Committee approved the appointment of PricewaterhouseCoopers, LLP (PwC) as the Association's independent auditors for 2010.


The fees for professional services rendered for the Association by its independent auditor, PwC, during 2010 were \$29,363 for audit services, and \$6,060 for tax services.

The Committee reviewed the non-audit services provided by PwC and concluded these services were not incompatible with maintaining the independent auditor's independence.

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

In this context, the Committee reviewed and discussed the Association's Quarterly Reports and the Association's financial statements for the year ended December 31, 2010 (the "Audited Financial Statements") with management. The Committee also reviews with PwC the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communication with Those Charged with Governance). Both PwC and the Association's internal auditors directly provide reports on significant matters to the Committee.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the Board of Directors include the Financial Statements in the Association's Annual Report to Shareholders for the year ended December 31, 2010.



Christopher Bledsoe, Chairman of the Audit Committee

### Audit Committee Members

David P. Aspenson, CPA, Vice Chairman  
Gary Pautler  
Terry James

Steve Wertz  
Mario Curto

March 16, 2011

## Consolidated Statement of Condition

(Dollars in Thousands)

	<b>December 31</b>		
	<b>2010</b>	2009	2008
<b>ASSETS</b>			
Loans	\$ 745,510	\$ 734,520	\$ 739,597
Less allowance for loan losses	3,706	3,401	2,588
Net loans	741,804	731,119	737,009
Cash	2,069	4,765	4,099
Accrued interest receivable	11,008	12,213	12,039
Investment in U.S. AgBank, FCB	20,064	20,064	19,481
Premises and equipment, net	2,576	2,383	1,895
Other property owned	1,812	3,003	-
Prepaid benefit expense	840	979	868
Deferred tax asset	-	20	4
Other assets	663	977	924
<b>Total assets</b>	<b>\$ 780,836</b>	<b>\$ 775,523</b>	<b>\$ 776,319</b>
<b>LIABILITIES</b>			
Note payable to U.S. AgBank, FCB	\$ 596,871	\$ 601,444	\$ 599,181
Advance conditional payments	761	94	1,272
Accrued interest payable	8,474	9,506	11,932
Patronage distributions payable	2,500	1,200	4,000
Accrued benefits liability	285	552	400
Other liabilities	2,547	2,752	2,898
<b>Total liabilities</b>	<b>611,438</b>	<b>615,548</b>	<b>619,683</b>
<b>Commitments and Contingencies (See Note 14)</b>			
<b>SHAREHOLDERS' EQUITY</b>			
Protected borrower stock	7	12	21
Preferred stock	11,726	10,414	10,877
Capital stock	1,448	1,486	1,517
Unallocated retained earnings	156,059	148,173	144,179
Accumulated other comprehensive income/(loss)	158	(110)	42
<b>Total shareholders' equity</b>	<b>169,398</b>	<b>159,975</b>	<b>156,636</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 780,836</b>	<b>\$ 775,523</b>	<b>\$ 776,319</b>

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

## Consolidated Statement of Income

(Dollars in Thousands)

	For the Year Ended December 31		
	2010	2009	2008
<b>INTEREST INCOME</b>			
Loans	\$ 38,880	\$ 39,911	\$ 44,407
<b>Total interest income</b>	<b>38,880</b>	<b>39,911</b>	<b>44,407</b>
<b>INTEREST EXPENSE</b>			
Note payable to U.S. AgBank, FCB	19,392	21,377	25,339
Other	-	-	12
<b>Total interest expense</b>	<b>19,392</b>	<b>21,377</b>	<b>25,351</b>
Net interest income	19,488	18,534	19,056
Provision for loan losses	1,518	2,493	20
Net interest income after provision for loan losses	17,970	16,041	19,036
<b>NONINTEREST INCOME</b>			
Financially related services income	154	188	119
Loan fees	555	1,006	676
Patronage distribution from Farm Credit institutions	1,169	342	2,980
Farm Credit Insurance Fund distribution	775	-	-
Other noninterest income	70	52	64
<b>Total noninterest income</b>	<b>2,723</b>	<b>1,588</b>	<b>3,839</b>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits	5,719	5,368	5,750
Occupancy and equipment	462	444	459
Purchased services from AgVantis, Inc.	649	559	526
Losses/(Gains) on other property owned, net	1,197	2,967	(26)
Farm Credit Insurance Fund premium	325	1,317	1,103
Supervisory and examination costs	273	251	230
Other noninterest expense	1,500	1,416	1,578
<b>Total noninterest expense</b>	<b>10,125</b>	<b>12,322</b>	<b>9,620</b>
Income before income taxes	10,568	5,307	13,255
Provision for income taxes	62	4	29
<b>Net income</b>	<b>\$ 10,506</b>	<b>\$ 5,303</b>	<b>\$ 13,226</b>

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

## Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

	Protected Borrower Stock	Preferred Stock	Capital Stock	Unallocated Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
<b>Balance at December 31, 2007</b>	\$ 25	\$ 11,964	\$ 1,610	\$ 135,195	\$ (118)	\$ 148,676
Adjustment to beginning balance due to pension accounting change				(12)		(12)
<b>Balance at January 1, 2008</b>	25	11,964	1,610	135,183	(118)	148,664
Comprehensive income						
Net income				13,226		
Change in retirement obligation					160	
Total comprehensive income						13,386
Stock issued	-	47,677	492			48,169
Stock retired	(4)	(48,994)	(585)			(49,583)
Preferred stock dividends		230		(230)		-
Patronage distributions: Cash				(4,000)		(4,000)
<b>Balance at December 31, 2008</b>	21	10,877	1,517	144,179	42	156,636
Comprehensive income						
Net income				5,303		
Change in retirement obligation					(152)	
Total comprehensive income						5,151
Stock issued	-	47,788	388			48,176
Stock retired	(9)	(48,360)	(419)			(48,788)
Preferred stock dividends		109		(109)		-
Patronage distributions: Cash				(1,200)		(1,200)
<b>Balance at December 31, 2009</b>	12	10,414	1,486	148,173	(110)	159,975
Comprehensive income						
Net income				10,506		
Change in retirement obligation					268	
Total comprehensive income						10,774
Stock issued	-	46,385	445			46,830
Stock retired	(5)	(45,193)	(483)			(45,681)
Preferred stock dividends		120		(120)		-
Patronage distributions: Cash				(2,500)		(2,500)
<b>Balance at December 31, 2010</b>	\$ 7	\$ 11,726	\$ 1,448	\$ 156,059	\$ 158	\$ 169,398

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

## Consolidated Statement of Cash Flows

(Dollars in Thousands)

	<b>For the Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 10,506	\$ 5,303	\$ 13,226
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:			
Depreciation	218	229	232
Provision for loan losses	1,518	2,493	20
Gains on sales of premises and equipment	(29)	(3)	(12)
Gains on sales of other property owned	-	-	(49)
Carrying value adjustment for other property owned	1,191	2,944	-
Change in assets and liabilities:			
Decrease/(Increase) in deferred tax asset	20	(16)	27
Decrease/(Increase) in accrued interest receivable	1,205	(174)	166
Decrease/(Increase) in prepaid benefit expense	139	(111)	(164)
Decrease/(Increase) in other assets	314	(53)	9
Decrease in accrued interest payable	(1,032)	(2,426)	(1,109)
Increase in accrued benefits liability	1	-	2
Decrease in other liabilities	(205)	(146)	(1,284)
Total adjustments	3,340	2,737	(2,162)
Net cash provided by operating activities	13,846	8,040	11,064
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Increase in loans, net	(12,203)	(2,550)	(93,198)
Increase in investment in U.S. AgBank, FCB	-	(583)	(1,435)
Expenditures for premises and equipment, net	(382)	(714)	(329)
Net cash used in investing activities	(12,585)	(3,847)	(94,711)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net (repayment of)/draw on note payable to U.S. AgBank, FCB	(4,573)	2,263	88,721
Increase/(Decrease) in advance conditional payments	667	(1,178)	(156)
Protected borrower stock retired	(5)	(9)	(4)
Preferred stock retired	(45,193)	(48,360)	(48,994)
Preferred stock issued	46,385	47,788	47,677
Capital stock retired	(483)	(419)	(585)
Capital stock issued	445	388	492
Cash patronage distributions paid	(1,200)	(4,000)	(6,000)
Net cash (used in)/provided by financing activities	(3,957)	(3,527)	81,151
Net (decrease)/increase in cash	(2,696)	666	(2,496)
Cash at beginning of year	4,765	4,099	6,595
Cash at end of year	\$ 2,069	\$ 4,765	\$ 4,099
<b>SUPPLEMENTAL CASH INFORMATION:</b>			
Cash paid during the year for:			
Interest	\$ 20,424	\$ 23,803	\$ 26,460
Income taxes	\$ 37	\$ 2	\$ 1
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>			
Loans transferred to other property owned	\$ -	\$ 5,947	\$ 202
Net charge-offs	\$ 1,213	\$ 1,680	\$ 53
Patronage distributions payable	\$ 2,500	\$ 1,200	\$ 4,000
Stock dividends declared and paid	\$ 120	\$ 109	\$ 230
Change in accumulated other comprehensive income/(loss)	\$ 268	\$ (152)	\$ 160

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(Dollars in Thousands, Except as Noted)

## **NOTE 1 – ORGANIZATION AND OPERATIONS**

- A. Organization: Farm Credit of Southern Colorado, ACA and its subsidiaries, Farm Credit of Southern Colorado, FLCA, (Federal Land Credit Association (FLCA)) and Farm Credit of Southern Colorado, PCA, (Production Credit Association (PCA)), (collectively called “the Association”) are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified agricultural purposes in the counties of Alamosa, Arapahoe, Archuleta, Baca, Bent, Chaffee, Cheyenne, Conejos, Costilla, Crowley, Custer, Douglas, El Paso, Elbert, Fremont, Hinsdale, Huerfano, Kiowa, Kit Carson, Lake, Las Animas, Lincoln, Mineral, Otero, Park, Prowers, Pueblo, Rio Grande, Saguache, Teller, and the southern half of Jefferson in the state of Colorado.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). At December 31, 2010, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and approximately 90 associations.

U.S. AgBank, FCB (AgBank), its related associations and AgVantis, Inc. (AgVantis) are collectively referred to as the District. AgBank provides the majority of funding to associations within the District and is responsible for supervising certain activities of the District Associations. AgVantis, which is owned by the entities it serves, provides technology and other operational services to AgBank and certain associations. On December 31, 2010, the District consisted of AgBank, 24 Agricultural Credit Association (ACA) parent companies, which each have two wholly owned subsidiaries, (a FLCA and a PCA), two FLCAs and AgVantis.

In November of 2010, the AgBank Board of Directors voted to pursue a merger with CoBank, another Farm Credit System Bank. The proposed merger is targeted to be effective on October 1, 2011. The Association does not expect there to be any material negative impact to its operations as a result of the merger.

ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. Generally, the FLCA makes secured long-term agricultural real estate and rural home mortgage loans and the PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System Banks and Associations. The FCA examines the activities of System institutions to ensure their compliance with the Farm Credit Act, FCA regulations and safe and sound banking practices.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). By law, the Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure the retirement of protected stock at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary use by the Insurance Corporation in providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System Bank has been required to pay premiums, which may be passed on to the Associations, into the Insurance Fund based on its annual average outstanding insured debt adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments until the assets in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate Insured Debt or such other percentage of the Insured Debt as the Insurance Corporation, in its sole discretion, determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, as necessary to maintain the Insurance Fund at the 2 percent level. As required by the Farm Credit Act, as amended, the Insurance Corporation may return excess funds above the secure base amount to System institutions. AgBank passes this premium expense through to each Association based on the Association’s average adjusted note payable with AgBank.

- B. Operations: The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be provided by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services

to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents and farm-related businesses.

The Association also offers credit life insurance, multi-peril crop and crop hail insurance, and provides additional services to borrowers such as appraisal services and an investment stock program.

The Association's financial condition may be impacted by factors affecting AgBank. Certain District expenses are allocated to the Associations. Disclosure of certain accounting policies related to these costs is included in the U.S. AgBank District Annual Report to Shareholders (District's Annual Report). The District's Annual Report is available free of charge on AgBank's website, [www.usagbank.com](http://www.usagbank.com); or may be obtained at no charge by contacting the Association at 3625 Citadel Drive South, Colorado Springs, Colorado 80909 or calling (800) 815-8559. Upon request, Association shareholders will be provided with a copy of the District's Annual Report, which includes the combined financial statements of AgBank and its related Associations, and AgVantis. The District's Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the District's Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities by the Insurance Corporation.

The lending and financial services offered by AgBank are described in Note 1 of AgBank's Annual Report.

## **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires Association management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from these estimates. Significant estimates are discussed in these footnotes as applicable. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to the current year's financial statement presentation.

The consolidated financial statements include the accounts of Farm Credit of Southern Colorado, FLCA and Farm Credit of Southern Colorado, PCA. All significant inter-company transactions have been eliminated in consolidation. Recently issued or adopted accounting pronouncements follow.

In July 2010, the Financial Accounting Standards Board (FASB) issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit 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, nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For non-public entities, all disclosures are effective for interim and annual reporting periods ending after December 15, 2011. The adoption of this Standard will not have an impact on the Association's financial condition or results of operations.

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 were effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard had no impact on the Association's financial condition and results of operations but resulted in expanded disclosures.

In June 2009, the FASB issued guidance on "Accounting for Transfers of Financial Assets," which amends previous guidance by improving the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. This guidance was effective as of the beginning of each reporting entity's first annual

reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application was prohibited. This Statement must be applied to transfers occurring on or after the effective date. System institutions reviewed their loan participation agreements to ensure that participations would meet the requirements for sales treatment and not be required to be consolidated. The impact of adoption on January 1, 2010 was immaterial to the Association's financial condition and results of operations.

Below is a summary of our significant accounting policies.

- A. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans made for agricultural production or operating purposes have maturities of ten years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loan origination fees and direct loan origination costs are capitalized and the net fee or cost is amortized over the life of the related loan as an adjustment to yield.

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

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately collateralized and in the process of collection) or when circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) and/or included in the recorded nonaccrual balance (if accrued in prior years). Loans are charged-off at the time they are determined to be uncollectible.

A restructured loan constitutes a troubled debt restructuring if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider.

When loans are in nonaccrual status, loan payments are generally applied against the recorded nonaccrual balance. A nonaccrual loan may, at times, be maintained on a cash basis. As a cash basis nonaccrual loan, the recognition of interest income from cash payments received is allowed when the collectibility of the recorded investment in the loan is no longer in doubt and the loan does not have a remaining unrecovered charge-off associated with it. Nonaccrual loans may be returned to accrual status when all contractual principal and interest is current, prior charge-offs have been recovered in full, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified Doubtful or Loss under the Uniform Classification System (UCS).

The Association uses a two-dimensional loan rating model based on an internally generated combined system risk rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provision for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, environmental conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and prior loan loss experience. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty, imprecision and variability. Changes in the agricultural economy and environment and their impact on borrower repayment capacity will cause various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the Association's expectations and predictions of those circumstances. Management considers the following factors in determining and supporting the level of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences.

A specific allowance may be established for impaired loans under GAAP. Impairment of these loans is measured by the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, by the loan's observable market price, or fair value of the collateral, if the loan is collateral dependent.

- B. Cash: Cash, as included in the consolidated financial statements, represents cash on hand and on deposit at financial institutions.
- C. Investment in AgBank: The Association's investment in AgBank is in the form of Class A Stock. The minimum required investment in AgBank is 5.00 percent of average direct loan volume, net of excess investment. The required investment will be adjusted on a quarterly basis to reflect changes in direct loan volume. The required investment may consist of AgBank surplus attributed to the Association, patronage based stock and purchased stock.
- D. Premises and Equipment: Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operating results. Maintenance and repairs are charged to operating expense and improvements above certain thresholds are capitalized.
- E. Other Property Owned: Other property owned, consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. On at least an annual basis, revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains/(losses) on other property owned in the Consolidated Statement of Income.
- F. Other Assets and Other Liabilities: Other assets are comprised primarily of accounts receivable, prepaid expenses, and investment in Farm Credit institutions. Significant components of other liabilities primarily include accounts payable and employee benefits.
- G. Advance Conditional Payments: The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Unrestricted advanced conditional payments are included in other interest bearing liabilities. Restricted advanced conditional payments are primarily associated with mortgage loans, while non-restricted are primarily related to production and intermediate-term loans and insurance proceeds on mortgage loans. Advance conditional payments are not insured. Interest is generally paid by the Association on advance conditional payments.
- H. Employee benefit plans: Substantially all employees of the Association participate in the Ninth Farm Credit District Pension Plan (Pension Plan) and/or the Farm Credit Foundations Defined Contribution/401(k) Plan (401(k) Plan). The Pension Plan is a non-contributory defined benefit plan. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and

contributes its proportional share of funding. Detailed financial information for the Pension Plan may be found in the District's Annual Report.

The Association also participates in the Farm Credit Foundations Retiree Medical Plan. These postretirement benefits (other than pensions) are provided to eligible retired employees of the Association. The anticipated costs of these benefits were accrued during the period of the employee's active service. The authoritative accounting guidance requires the accrual of the expected cost of providing postretirement benefits during the years that the employee renders service necessary to become eligible for these benefits.

- I. Patronage Distribution from AgBank: Patronage distributions are made by AgBank annually, except for certain priority patronage. The Association records patronage distributions from AgBank upon receipt of the distribution.
- J. Income Taxes: As previously described, the ACA holding company conducts its business activities through two wholly owned subsidiaries. Long-term mortgage lending activities are operated through a wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through a wholly owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income taxes. The Association accounts for income taxes under the liability method. Accordingly, deferred taxes are recognized for estimated taxes ultimately payable or recoverable based on federal, state or local laws.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage distributions. Deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the Association 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, the deferred tax assets will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings.

Deferred income taxes have not been recorded by the Association on stock patronage distributions received from AgBank prior to January 1, 1993, the adoption date of FASB guidance on income taxes. Association management intent is to permanently invest these and other undistributed earnings in AgBank, or if converted to cash, to pass through any such earnings to Association borrowers through qualified patronage allocations.

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

- K. Other Comprehensive Income/Loss: Other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of shareholders' equity but are excluded from net income. The Association records other comprehensive income/loss associated with the liability under the Pension Restoration Plan.
- L. Fair Value Measurement: FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets include assets held in trust funds which relate to deferred compensation and the supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

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

Level 3 — Unobservable inputs are those that are supported by little or no market activity and that are significant to the determination of the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions that market participants would use in pricing the asset or liability. Level 3 assets include certain loans and other property owned.

The fair value disclosures are presented in Note 16.

- M. Off-balance-sheet credit exposures: Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

### **NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES**

A summary of loans follows.

	<b>December 31</b>		
	<b>2010</b>	2009	2008
Real estate mortgage	<b>\$ 427,422</b>	\$ 423,257	\$ 392,271
Production and intermediate-term Agribusiness:	<b>167,528</b>	155,177	142,604
Loans to cooperatives	<b>22,371</b>	10,124	8,710
Process and marketing	<b>63,966</b>	79,932	120,222
Farm related business	<b>12,843</b>	16,225	19,857
Communication	<b>21,507</b>	16,660	29,652
Energy	<b>19,038</b>	24,011	19,047
International	<b>10,215</b>	8,413	6,417
Rural residential real estate	<b>620</b>	721	817
<b>Total loans</b>	<b>\$ 745,510</b>	\$ 734,520	\$ 739,597

The Association's concentration of credit risk in various agricultural commodities is shown in the following table.

SIC Category	<b>December 31</b>					
	2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent
Cattle	<b>\$ 167,367</b>	<b>22.45%</b>	\$ 164,532	22.40%	\$ 165,596	22.39%
Wheat	<b>128,153</b>	<b>17.19%</b>	128,761	17.53%	105,023	14.20%
Corn	<b>68,214</b>	<b>9.15%</b>	65,152	8.87%	65,232	8.82%
Timber	<b>44,582</b>	<b>5.98%</b>	44,585	6.07%	51,254	6.93%
Hay	<b>43,985</b>	<b>5.90%</b>	39,517	5.38%	37,645	5.09%
Potatoes	<b>41,525</b>	<b>5.57%</b>	38,122	5.19%	35,649	4.82%
Other	<b>251,684</b>	<b>33.76%</b>	253,851	34.56%	279,198	37.75%
<b>Total</b>	<b>\$ 745,510</b>	<b>100.00%</b>	\$ 734,520	100.00%	\$ 739,597	100.00%

While the percentages shown in the previous table represent the relative amounts of the Association's potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's loans are collateralized. Accordingly, the Association's exposure to credit loss associated with lending activities is considerably less than the

recorded loan balances. An estimate of the Association's current loss exposure is indicated in the consolidated financial statements in the allowance for loan losses.

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

Credit enhancements with government agencies of \$12,308 at year-end 2010, \$9,572 at year-end 2009 and \$7,220 at year-end 2008 were outstanding.

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

	<b>December 31</b>		
	<b>2010</b>	2009	2008
Nonaccrual loans:			
Current as to principal and interest	<b>\$ 5,295</b>	\$ 831	\$ 4,683
Past due	<b>8,675</b>	10,295	9,354
<b>Total nonaccrual loans</b>	<b>13,970</b>	11,126	14,037
Impaired accrual loans:			
Restructured	<b>4</b>	5	109
90 days or more past due	-	-	4,225
<b>Total impaired accrual loans</b>	<b>4</b>	5	4,334
<b>Total impaired loans</b>	<b>\$ 13,974</b>	\$ 11,131	\$ 18,371

Commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2010 totaled \$627 compared to none at December 31, 2009 and 2008. These commitments were considered when establishing the allowance for loan losses for December 31, 2010.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans and average impaired loans.

	<b>Year Ended December 31</b>		
	<b>2010</b>	2009	2008
Interest income recognized on:			
Nonaccrual loans	<b>\$ 13</b>	\$ 291	\$ 492
Accrual loans 90 days or more past due	<b>76</b>	52	126
Restructured accrual loans	-	1	7
<b>Interest income recognized on impaired loans</b>	<b>\$ 89</b>	\$ 344	\$ 625
<b>Average impaired loans</b>	<b>\$ 14,678</b>	\$ 18,357	\$ 14,320

The following table presents additional information concerning impaired loans (including accrued interest).

	<b>December 31</b>		
	<b>2010</b>	2009	2008
Impaired loans with related allowance	<b>\$ 3,887</b>	\$ 2,844	\$ -
Impaired loans with no related allowance	<b>10,087</b>	8,287	18,371
<b>Total impaired loans</b>	<b>\$ 13,974</b>	\$ 11,131	\$ 18,371
<b>Allowance on impaired loans</b>	<b>\$ 1,039</b>	\$ 625	\$ -

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans follows.

	Year Ended December 31		
	2010	2009	2008
Interest income which would have been recognized under the original loan terms	\$ 950	\$ 833	\$ 1,074
Less: interest income recognized	13	292	499
Foregone interest income	\$ 937	\$ 541	\$ 575

A summary of the changes in the allowance for loan losses follows.

	2010	2009	2008
Balance at beginning of year	\$ 3,401	\$ 2,588	\$ 2,621
Charge-offs:			
Real estate mortgage	–	33	–
Production and intermediate-term	95	52	–
Agribusiness	1,110	945	7
Communication	42	650	55
Total charge-offs	1,247	1,680	62
Recoveries:			
Production and intermediate-term	1	–	9
Communication	33	–	–
Total recoveries	34	–	9
Net charge-offs	1,213	1,680	53
Provision for loan losses	1,518	2,493	20
Balance at December 31	\$ 3,706	\$ 3,401	\$ 2,588
Net charge-offs to average net loans	0.17%	0.23%	0.01%

A breakdown of the allowance for loan losses by type of loan and the percent of total allowance follows.

	December 31					
	2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent
Real estate mortgage	\$ 796	21.48%	\$ 741	21.79%	\$ 614	23.72%
Production and intermediate-term	845	22.80%	1,182	34.76%	1,035	39.99%
Agribusiness	1,844	49.76%	1,355	39.84%	781	30.18%
Communication	56	1.51%	43	1.26%	82	3.17%
Energy	160	4.32%	63	1.85%	76	2.94%
International	5	0.13%	17	0.50%	–	–
Total	\$ 3,706	100.00%	\$ 3,401	100.00%	\$ 2,588	100.00%

#### **NOTE 4 – INVESTMENT IN AGBANK**

The Association is required to maintain an investment in AgBank equal to 5.00 percent of average direct loan volume, net of excess investment. The Association's investment in AgBank may consist of AgBank surplus attributed to the Association, patronage based stock and purchased stock. The Association's stock investment in AgBank is in the form of Class A Stock. The investment in AgBank is adjusted on a quarterly basis to reflect changes in direct loan volume, attributed surplus and stock investment balances. If needed to meet capital adequacy requirements, AgBank may require the Association to purchase at-risk stock subject to a limit of one percent of the Association's average Direct Loan Volume in a twelve month period.

**NOTE 5 – PREMISES AND EQUIPMENT**

Premises and equipment consisted of the following.

	<b>December 31</b>		
	<b>2010</b>	2009	2008
Land	\$ 892	\$ 892	\$ 314
Buildings and leasehold improvements	2,253	2,161	2,113
Furniture, equipment and automobiles	1,581	1,477	1,505
Construction in progress	55	29	–
	<b>4,781</b>	4,559	3,932
Less: accumulated depreciation	2,205	2,176	2,037
Total	<b>\$ 2,576</b>	\$ 2,383	\$ 1,895

**NOTE 6 – OTHER PROPERTY OWNED**

(Gains)/Losses on other property owned, net as reflected on the Consolidated Statement of Income consists of the following.

	<b>December 31</b>		
	<b>2010</b>	2009	2008
Gains on sales, net	\$ –	\$ –	\$ (49)
Carrying value adjustments	1,191	2,944	–
Operating expense, net	6	23	23
Losses/(Gains) on other property owned, net	<b>\$ 1,197</b>	\$ 2,967	\$ (26)

**NOTE 7 – NOTE PAYABLE TO AGBANK**

The Association's indebtedness to AgBank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and is governed by a General Financing Agreement (GFA) which provides for a \$650.0 million line of credit. The GFA and promissory note are subject to periodic renewals in the normal course of business. The Association was in compliance with the terms and conditions of the GFA as of December 31, 2010. Substantially all borrower loans are match-funded with AgBank. Payments and disbursements are made on the note payable to AgBank on the same basis the Association collects payments from and disburses on borrower loans. The interest rate may periodically be adjusted by AgBank based on the terms and conditions of the borrowing. The weighted average interest rate was 3.31 percent for the year ended December 31, 2010. The line of credit expires on April 30, 2011; however, the Association expects renewal of the line of credit. Upon expiration of the line of credit, undisbursed amounts available under the line of credit expire. So long as the Association is not in material default under the GFA, AgBank will continue to make advances (that do not exceed the amount payable under the promissory note) for undisbursed outstanding commitments on borrower loans which are not in default. The note payable to AgBank will continue until it has been fully discharged.

The Association has the opportunity to commit funds with AgBank in the Earnings Stabilization Management Program at a fixed rate for a specified timeframe. Participants in the program receive a fixed rate credit on the committed funds balance classified as a reduction of interest expense. These committed funds, which are netted against the note payable to AgBank, as of December 31, follow.

	<b>2010</b>	2009	2008
Committed funds	<b>\$ 9,300</b>	\$ 19,300	\$ 4,100
Average rates	<b>1.81%</b>	1.57%	3.10%

Under the Farm Credit Act, the Association is obligated to borrow only from AgBank, unless AgBank gives approval to borrow elsewhere. AgBank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2010, the Association's notes payable are within the specified limitations.

## **NOTE 8 – SHAREHOLDERS’ EQUITY**

Descriptions of the Association’s capitalization, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

### A. Protected Stock

Protection of certain stock is provided under the Farm Credit Act which requires the Association, when retiring protected stock, to retire it at par or stated value regardless of its book value. Protected stock includes stock and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an association is unable to retire protected stock at par value or stated value, amounts required to retire this stock would be obtained from the Insurance Fund.

### B. Stock

In accordance with the Farm Credit Act, each borrower is required to invest in the Association as a condition of borrowing. The borrower normally acquires ownership of the stock at the time the loan is made, but usually does not make a cash investment. Generally, the aggregate par value of the stock is added to the principal amount of the related loan obligation. The Association has a first lien on the stock owned by its borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock.

Capitalization bylaws allow stock requirements to range from the lesser of one thousand dollars or 2.00 percent of the amount of the loan to 10.00 percent of the loan. The Board of Directors has the authority to change the minimum required stock level of a shareholder as long as the change is within this range. Currently, the Association has a stock requirement of the lesser of one thousand dollars or 2.00 percent of the amount of the borrower’s combined loan volume.

### C. Regulatory Capitalization Requirements and Restrictions

The FCA’s capital adequacy regulations require the Association to maintain permanent capital of 7.00 percent of average risk-adjusted assets. Failure to meet the requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association’s consolidated financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. The FCA regulations also require other additional minimum standards for capital be maintained. These standards require all System institutions to achieve and maintain ratios of total surplus as a percentage of average risk-adjusted assets of 7.00 percent and of core surplus (generally unallocated surplus) as a percentage of average risk-adjusted assets of 3.50 percent. At December 31, 2010, the Association’s permanent capital ratio was 19.85 percent, total surplus ratio was 18.01 percent and core surplus ratio was 17.58 percent.

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

### D. Description of Equities

The following paragraphs describe the attributes of each class of stock authorized by the Association bylaws and indicates the number of shares outstanding at December 31, 2010. Unless otherwise indicated all classes of stock have a par value of \$5.00.

- |         |   |
|---------|---|
| Class A | Common Stock (Nonvoting, at-risk, no shares outstanding) – Issued in exchange for Class B Common Stock or Class C Common Stock; as a patronage refund; as a dividend; or in exchange for allocated surplus. Retirement is at the sole discretion of the Board of Directors.   |
| Class B | Common Stock (Voting, at-risk, 281,779 shares outstanding) – Issued solely to, and shall be acquired by, borrowers and other applicants who are farmers, ranchers, or producers or harvesters of aquatic products and who are eligible to vote. Class B Common Stock may also be held by those borrowers who exchanged one share of Class F Common Stock for one share of Class B Common Stock. Each Class B Common shareholder shall hold at least one share as long as the holder continues business with the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class B Common Stock |

shall be converted to Class A Common Stock. Retirement is at the sole discretion of the Board of Directors.

- Class C Common Stock (Nonvoting, at-risk, 7,858 shares outstanding) – Class C Common Stock may be issued to borrowers or applicants who are: (a) rural residents, including persons eligible to hold voting stock, to capitalize rural housing loans; (b) persons or organizations furnishing farm-related services; (c) other persons or organizations who are eligible to borrow from or participate with the Association but who are not eligible to hold voting stock. Class C Common Stock may be issued to any person who is not a shareholder but who is eligible to borrow from the Association for the purpose of qualifying such person for technical assistance, financially related services and leasing services offered by the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class C Common Stock shall be converted to Class A Common Stock. Retirement is at the sole discretion of the Board of Directors.
- Class D Common Stock (Nonvoting, at-risk, no shares outstanding, par value of one thousand dollars) – Issued to AgBank or to any person through direct sale.
- Class E Preferred Stock (Nonvoting, at-risk, no shares outstanding, par value as may be determined by any agreement of financial assistance between the Association and AgBank) - Issued only to AgBank in consideration of financial assistance to the Association from AgBank. Retirement is at the sole discretion of the Board of Directors.
- Class F Common Stock (Voting, protected, 975 shares outstanding) – Shall be issued to those individuals and entities who held the same class of stock in a predecessor to the Association. The Association shall not issue any additional Class F Common Stock. Each Class F Common shareholder shall hold at least one share as long as the holder continues business with the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class F Common Stock shall be converted to Class G Common Stock. Retirement is at the sole discretion of the Board of Directors.
- Class G Common Stock (Nonvoting, protected, 396 shares outstanding) – Issued only to those individuals and entities who held the same class of stock in a predecessor to the Association and as necessary for conversions from Class F Common Stock. No further shares of Class G Common Stock will be issued. It must be retired upon repayment of the loan.
- Class H Preferred Stock (Nonvoting, at-risk, 1,172,572,242 shares outstanding, par value of one cent) – Issued to and may be acquired only by: (1) owners of any class of Common Stock; (2) holders of Class A Preferred Stock and, (3) holders of Class H Preferred Stock who are eligible to receive a dividend.

E. Patronage and/or Dividends

Dividends may be declared and paid to holders of Class H Stock on a quarterly basis based on a dividend rate determined by the Board of Directors. Dividends paid on the stock will be applied towards the purchase of additional shares of the stock at par value.

Dividends may be declared or patronage distributions allocated to holders of Class B, C, F and G Stock out of the whole or any part of net earnings which remain at the end of the fiscal year, as the Board of Directors may determine, in accordance with the regulations for banks and associations of the System. Additionally, patronage distributions may be allocated to System institutions, with or for whom the Association conducts specified business transactions. However, distributions and retirements are precluded by regulation until the minimum capital adequacy standards have been attained. Amounts not distributed are retained as unallocated retained earnings. The Association made a cash patronage distribution of \$1,200 in 2010, \$4,000 in 2009 and \$6,000 in 2008. The Association declared a \$2,500 cash patronage to be distributed in 2011.

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to retire stock in the following order of priority: First, to the holders of all classes of Class E Preferred Stock (if any) until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders; second, to the holders of all classes of Class H Preferred Stock until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders; third, to the holders, pro rata, of all

classes of common stock, until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders; fourth, any remaining assets of the Association after such distributions shall be distributed to present and former members and other patrons on a patronage basis, to the extent practicable.

At each year end, the Board of Directors evaluates whether to retain the Association's net income to strengthen its capital position or to distribute a portion of the net income to customers by declaring a qualified/cash patronage refund. For 2010, the Association allocated 23.98 percent of its patronage-sourced net income to its patrons.

#### F. Other Comprehensive Income/Loss

The Association reports other comprehensive income/loss in its Consolidated Statement of Changes in Shareholder's Equity. As more fully described in Note 2, other comprehensive income/loss results from the recognition of the Pension Restoration Plan's net unamortized gains and losses and prior service costs or credits of income of \$158 in 2010, loss of \$110 in 2009 and income of \$42 in 2008. There were no other items affecting comprehensive income or loss.

### **NOTE 9 – PATRONAGE DISTRIBUTION FROM FARM CREDIT INSTITUTIONS**

Patronage paid by Farm Credit Institutions to the Association follows.

	2010	2009	2008
AgBank	\$ 1,147	\$ 322	\$ 2,945
CoBank	22	20	35
Total	\$ 1,169	\$ 342	\$ 2,980

Patronage distributed from AgBank was in cash and patronage distributed from CoBank was in stock.

### **NOTE 10 – INCOME TAXES**

The provision for income taxes follows.

	Year Ended December 31		
	2010	2009	2008
Current:			
Federal	\$ 35	\$ 16	\$ 1
State	7	4	1
Deferred:			
Federal	16	(12)	24
State	4	(4)	3
Provision for income taxes	\$ 62	\$ 4	\$ 29

The provision for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows.

	Year Ended December 31		
	2010	2009	2008
Federal tax at statutory rate	\$ 3,593	\$ 1,804	\$ 4,507
State tax, net	7	–	3
Effect of non-taxable entity	(2,988)	(1,498)	(4,073)
Patronage distributions	(537)	(408)	(282)
Change in valuation allowance	(3)	117	(123)
Other	(10)	(11)	(3)
Provision for income taxes	\$ 62	\$ 4	\$ 29

Deferred tax assets and liabilities are comprised of the following.

	<b>December 31</b>		
	<b>2010</b>	2009	2008
Deferred income tax assets:			
Allowance for loan losses	\$ 368	\$ 434	\$ 305
Nonaccrual loan interest	105	59	48
Charitable contribution carryover	4	4	4
Gross deferred tax assets	477	497	357
Deferred tax asset valuation allowance	(459)	(461)	(335)
Deferred income tax liabilities:			
Depreciation	(15)	(13)	(15)
Sale of fixed assets	(1)	(1)	(1)
Gain on installment sales	(2)	(2)	(2)
Gross deferred tax liability	(18)	(16)	(18)
Net deferred tax asset	\$ -	\$ 20	\$ 4

The calculation of deferred tax assets and liabilities involves various management estimates and assumptions as to future taxable earnings, including the amount of non-patronage income and patronage income retained. The expected future tax rates are based upon enacted tax laws.

The Association recorded a valuation allowance of \$459 during 2010, \$461 during 2009 and \$335 during 2008. The Association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

The Association has no uncertain tax positions as of December 31, 2010, 2009 or 2008. The tax years that remain open for federal and major state income tax jurisdictions are 2007 and forward.

#### **NOTE 11 – EMPLOYEE BENEFIT PLANS**

The employees of the Association may participate in the District's defined benefit pension plan (Pension Plan). The Pension Plan is noncontributory and covers a significant number of employees. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and contributes its proportional share of funding. As a participant in the District's defined benefit plan, the Association funded \$364 for 2010, \$412 for 2009 and \$428 for 2008, through its note payable to AgBank. Pension Plan expenses included in salaries and employee benefits expense were \$503 for 2010, \$301 for 2009 and \$274 for 2008. Additional financial information for the Pension Plan may be found in the District's Annual Report.

Postretirement benefits other than pensions are provided through the Farm Credit Foundations Retiree Medical Plan to retired employees of the Association. Benefits provided are determined on a graduated scale based on years of service. The anticipated costs of these benefits were accrued during the period of the employee's active service. Postretirement benefits expense (primarily health care benefits) included in salaries and employee benefits were \$5 for 2010, \$20 for 2009 and \$17 for 2008. During 2008, the life insurance benefit in the plan was funded by a one-time buy-out contribution with an insurance company resulting in income recognition of \$6 and additional cash contributions of \$42. Additional financial information for this plan may be found in the District's Annual Report.

The Association participates in a District-wide non-qualified defined benefit Pension Restoration Plan that is unfunded. The purpose of the Pension Restoration Plan is to supplement a participant's benefits under the District's other retirement plans to the extent that such benefits are reduced by the limitations imposed by the Internal Revenue Code. Benefits payable under the Pension Restoration Plan are offset by the benefits payable from the Pension Plan. Pension Restoration Plan expenses included in salaries and employee benefits were \$48 for 2010, \$14 for 2009 and \$48 in 2008.

FASB guidance requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans as an asset or liability with an offsetting adjustment to accumulated other comprehensive income on the balance sheet. This guidance also requires that the benefit obligation and plan assets be measured as of the fiscal year-end for years ending after December 15, 2008. The guidance provided two approaches for an employer to transition to a fiscal year end measurement date. The District applied the second approach which allowed for the use of the measurements determined for the prior year end. Under this second approach, pension benefit expense measured for the three-month period October 1, 2007, to December 31, 2007 (determined using the September 2007

measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As a result, the Association decreased retained earnings \$12, net of tax and increased the pension restoration liability by \$12.

The funding status and the amounts recognized in the Consolidated Statement of Condition for the Association's Pension Restoration Plan follows:

	<b>Nonqualified Pension Benefits</b>		
	2010	2009	2008
<b>Change in projected benefit obligation:</b>			
Benefit obligation at the beginning of the period	\$ 309	\$ 143	\$ 243
Service cost	11	13	12
Interest cost	17	9	19
Actuarial (gain)/loss	(248)	144	(131)
Benefits paid	(30)	144	(131)
Benefit obligation at the end of the period	\$ 59	\$ 309	\$ 143
Fair value of plan assets at the end of the period	-	-	-
Funded status of the plan	\$ (59)	\$ (309)	\$ (143)
<b>Amounts recognized in the Consolidated Statement of Condition consist of:</b>			
Liabilities	\$ 59	\$ 309	\$ 143
Net amount recognized	\$ 59	\$ 309	\$ 143

The following table represents the amounts included in accumulated other comprehensive income/loss for the Pension Restoration Plan at December 31:

	2010	2009	2008
Net actuarial gain/(loss)	\$ 160	\$ (107)	\$ (3)
Prior service (costs)/credits	(2)	(3)	45
Total amount recognized in AOCI/(loss)	\$ 158	\$ (110)	\$ 42

An estimated net actuarial gain of \$39 and prior service cost of \$1 for the Pension Restoration Plan will be amortized into income over the next year.

The projected and accumulated benefit obligation for the Pension Restoration Plan at December 31 was:

	2010	2009	2008
Projected benefit obligation	\$ 59	\$ 309	\$ 143
Accumulated benefit obligation	\$ 59	\$ 180	\$ 104

The net periodic pension expense for the defined benefit pension restoration plan included in the Consolidated Statement of Income is comprised of the following at December 31.

	<b>Pension Benefits</b>		
	2010	2009	2008
<b>Components of net periodic benefit cost</b>			
Service cost	\$ 11	\$ 13	\$ 9
Interest cost	17	9	15
Net amortization and deferral	20	(8)	24
Net periodic benefit cost	\$ 48	\$ 14	\$ 48

The adjustment to retained earnings due to the change in measurement date is detailed below.

	2008
Service cost	\$ (2)
Interest cost	(4)
Amortization of net actuarial loss	(6)
Total adjustment to retained earnings	\$ (12)

Changes in benefit obligation recognized in accumulated other comprehensive income are included in the following table.

	2010	2009	2008
Current year net actuarial loss	\$ (248)	\$ 144	\$ 131
Amortization of prior service cost	(1)	–	1
Amortization of net actuarial loss	(19)	8	22
Adjustment due to change in measurement date	–	–	6
Total recognized in other comprehensive income	\$ (268)	\$ 152	\$ 160

Weighted average assumptions used to determine benefit obligation at December 31:

	Pension Benefits		
	2010	2009	2008
Discount rate	5.30%	5.65%	6.35%
Rate of compensation increase	5.00%	5.00%	5.00%

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	Pension Benefits		
	2010	2009	2008
Discount rate	5.65%	6.35%	6.35%
Rate of compensation increase	5.00%	5.00%	5.00%

The Association expects to contribute \$30 to the pension restoration plan in 2011.

**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension Restoration Benefits	
2011	\$	30
2012	\$	30
2013	\$	–
2014	\$	–
2015	\$	–
2016 – 2020	\$	–

The Association also participates in the Farm Credit Foundations Defined Contribution/401(k) Plan (Contribution Plan). Employees who do not participate in the Pension Plan may receive benefits through the Employer Contribution portion of the Contribution Plan. In this plan, the Association provides a monthly contribution based on a defined percentage of the employee’s salary. Employees may also participate in a Salary Deferral Plan governed by Section 401(k) of the Internal Revenue Code. The Association matches a certain percentage of employee contributions to the plan. Employer contributions to this plan were \$280 in 2010, \$261 in 2009 and \$283 in 2008.

**NOTE 12 – RELATED PARTY TRANSACTIONS**

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates, amortization schedules and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

The Association has a policy that loans to directors and senior officers must be maintained at an Acceptable or Other Assets Especially Mentioned (OAEM) credit classification. If the loan falls below the OAEM credit classification, corrective action must be taken and the loan brought back to either Acceptable or OAEM within 24 months . If not, the director or senior officer must resign from the Board or employment.

Loan information to related parties for the years ended December 31 is shown below.

	2010	2009	2008
New loans	\$ 7,731	\$ 8,333	\$ 9,713
Repayments	\$ 6,923	\$ 6,689	\$ 10,304
Ending balance	\$ 15,158	\$ 8,686	\$ 6,258

In the opinion of management, none of the loans outstanding to officers and directors at December 31, 2010 involved more than a normal risk of collectibility.

The Association also has business relationships with certain other System entities. The Association paid \$649 in 2010, \$559 in 2009 and \$526 in 2008 to AgVantis for technology services and \$80 in 2010, \$74 in 2009 and \$63 in 2008 to AgBank for operational services.

### **NOTE 13 – REGULATORY ENFORCEMENT MATTERS**

There are no regulatory enforcement actions in effect for the Association.

### **NOTE 14 – COMMITMENTS AND CONTINGENCIES**

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. At December 31, 2010, \$171,151 of commitments to extend credit were outstanding.

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

The Association also participates in standby letters of credits to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2010, \$4,459 of standby letters of credit were outstanding with a nominal fair value. Outstanding standby letters of credit have expiration dates ranging from January 2011 to December 2016. The maximum potential amount of future payments the Association is required to make under the guarantees is \$4,459.

With regard to contingent liabilities, there are no actions pending against the Association in which claims for monetary damages are asserted.

### **NOTE 15 – FAIR VALUE MEASUREMENTS**

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. The fair value measurement is not an indication of liquidity. See Note 2 for additional information. Assets measured at fair value on a recurring basis at December 31 for each of the fair value hierarchy values are summarized below:

	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets held in nonqualified benefits trusts				
2010	\$ 176	\$ –	\$ –	\$ 176
2009	\$ 573	\$ –	\$ –	\$ 573
2008	\$ 535	\$ –	\$ –	\$ 535

During the three years presented, the Association recorded no transfers in or out of Levels 1, 2, or 3.

The Association has no liabilities measured at fair value on a recurring basis for the periods presented.

Assets measured at fair value on a non-recurring basis at December 31 for each of the fair value hierarchy values are summarized below:

	Fair Value Measurement Using			Total Fair Value	Total Losses
	Level 1	Level 2	Level 3		
<b>2010</b>					
Loans	\$ -	\$ -	\$ 3,385	\$ 3,385	\$ 1,539
Other property owned	\$ -	\$ -	\$ 1,928	\$ 1,928	\$ 1,190
2009					
Loans	\$ -	\$ -	\$ 6,206	\$ 6,206	\$ 1,840
Other property owned	\$ -	\$ -	\$ 3,195	\$ 3,195	\$ 2,977
2008					
Loans	\$ -	\$ -	\$ 164	\$ 164	\$ 42

The Association has no liabilities measured at fair value on a non-recurring basis for any of the periods presented.

### **Valuation Techniques**

As more fully discussed in Note 2, accounting 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 presents a brief summary of the valuation techniques used by the Association for assets and liabilities subject to fair value measurement:

#### *Assets Held in Non-Qualified 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 FASB impairment guidance, the fair value is based upon the underlying collateral since the loans are 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 and the net loan is reported at its fair value.

#### *Other Property Owned*

Other property owned is generally classified as Level 3. The process for measuring the fair value of other property owned involves the use of appraisals or other market-based information. As a result, these fair value measurements fall within Level 3 of the hierarchy. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

## **NOTE 16 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

The estimated fair values of the Association's financial instruments follow.

	December 31					
	2010		2009		2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:						
Loans, net	\$ 741,804	\$ 751,969	\$ 731,119	\$ 735,779	\$ 737,009	\$ 749,407
Cash	\$ 2,069	\$ 2,069	\$ 4,765	\$ 4,765	\$ 4,099	\$ 4,099
Investment in AgBank	\$ 20,064	\$ 20,064	\$ 20,064	\$ 20,064	\$ 19,481	\$ 19,481
Assets held in nonqualified benefit trusts	\$ 176	\$ 176	\$ 573	\$ 573	\$ 535	\$ 535
Financial liabilities:						
Note payable to AgBank	\$ 596,871	\$ 608,228	\$ 601,444	\$ 609,199	\$ 599,181	\$ 615,296
Advance conditional payments	\$ 761	\$ 761	\$ 94	\$ 94	\$ 1,272	\$ 1,272
Commitments to extend credit	\$ -	\$ 12	\$ -	\$ NA	\$ -	\$ NA
Standby letters of credit	\$ -	\$ 40	\$ -	\$ NA	\$ -	\$ NA

NA – Not available

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

- A. Loans and notes receivable: Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. Since the discount rates are based on the Association's loan rates as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining the fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in a nonaccrual status is estimated as described above, with appropriately higher interest rates, which reflect the uncertainty of continued cash flows. For noncurrent nonaccrual loans, it is assumed that collection will result only from the disposition of the underlying collateral. Fair value of these loans is estimated to equal the aggregate net realizable value of the underlying collateral, discounted at an interest rate, which appropriately reflects the uncertainty of the expected future cash flows over the average disposal period. Where the net realizable value of the collateral exceeds the legal obligation for a particular loan, the legal obligation is generally used in place of the net realizable value.

- B. Cash: The carrying value is a reasonable estimate of fair value.
- C. Investment in AgBank: Estimating the fair value of the Association's investment in AgBank is not practicable because the stock is not traded. As described in Note 4, the investment is a requirement of borrowing from AgBank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 3.18 percent of the issued stock of AgBank as of December 31, 2010. As of that date, AgBank's assets total \$25.39 billion and shareholders' equity totaled \$1.37 billion. AgBank's earnings were \$136.6 million during 2010.
- D. Assets held in nonqualified benefits trusts: These assets relate to deferred compensation and supplemental retirement plans. As discussed in Note 15, the fair value of these assets is determined by quoted net asset values.
- E. Notes payable to AgBank: The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets), which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current interest rate that would be charged for borrowings. For purposes of this estimate, it is assumed the cash flow on the notes payable is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable.
- F. Advance conditional payments: The carrying value is a reasonable estimate of fair value as these funds are held in cash.

- G. Commitments to Extend Credit and Standby Letters of Credit: The fair value of commitments reflects the estimated gain/(loss) assuming undrawn loan commitments are recorded as new loan volume on the fair value measurement date, and considers the difference between current levels of interest rates and the committed rates. The fair value of the standby letters of credit represents discounted fee income cash flows. The fair value of letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

### **NOTE 17 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Quarterly results of operations for the years ended December 31, 2010, 2009 and 2008, follow.

	2010				
	First	Second	Third	Fourth	Total
Net interest income	\$ 4,923	\$ 4,522	\$ 4,753	\$ 5,290	\$ 19,488
Provision for loan losses	212	294	991	21	1,518
Noninterest expense, net	54	1,859	1,982	3,569	7,464
<b>Net income</b>	<b>\$ 4,657</b>	<b>\$ 2,369</b>	<b>\$ 1,780</b>	<b>\$ 1,700</b>	<b>\$ 10,506</b>

	2009				
	First	Second	Third	Fourth	Total
Net interest income	\$ 4,203	\$ 4,574	\$ 4,719	\$ 5,038	\$ 18,534
Provision for loan losses	648	1,050	447	348	2,493
Noninterest expense, net	1,706	1,985	4,671	2,376	10,738
<b>Net income/(loss)</b>	<b>\$ 1,849</b>	<b>\$ 1,539</b>	<b>\$ (399)</b>	<b>\$ 2,314</b>	<b>\$ 5,303</b>

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 4,796	\$ 4,635	\$ 4,687	\$ 4,938	\$ 19,056
(Loan loss reversal)/Provision for loan losses	(83)	(160)	31	232	20
Noninterest expense, net	859	1,348	1,438	2,165	5,810
<b>Net income</b>	<b>\$ 4,020</b>	<b>\$ 3,447</b>	<b>\$ 3,218</b>	<b>\$ 2,541</b>	<b>\$ 13,226</b>

### **NOTE 18 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events through March 16, 2011, which is the date the financial statements were issued, and no material subsequent events were identified.



### Report of Independent Auditors

To the Board of Directors and Shareholders of  
Farm Credit of Southern Colorado, ACA:

In our opinion, the accompanying consolidated statements of condition and the related consolidated statements of income, of changes in shareholders' equity, and of cash flows present fairly, in all material respects, the financial position of Farm Credit of Southern Colorado, ACA and subsidiaries (the Association) at December 31, 2010, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers LLP*

March 16, 2011

# DISCLOSURE INFORMATION REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

(Amounts in Whole Dollars)

## **DESCRIPTION OF BUSINESS**

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

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, required to be disclosed in this section, is incorporated herein by reference from "Management's Discussion and Analysis" (MD&A) included in this annual report to shareholders.

## **DESCRIPTION OF PROPERTY**

The following table sets forth certain information regarding the properties of the Association:

Location	Description	Form of Ownership
3625 Citadel Drive South Colorado Springs, Colorado	Administrative Office and Lending Office	Owned
5110 Edison Avenue Colorado Springs, Colorado	Land	Owned
162 Mike Lounge Drive Burlington, Colorado	Lending Office	Owned
1302 East Third La Junta, Colorado	Lending Office	Owned
201 South Fifth Lamar, Colorado	Lending Office	Owned
100 East Main Limon, Colorado	Lending Office	Owned
159 Washington Street Monte Vista, Colorado	Lending Office	Owned

## **LEGAL PROCEEDINGS AND ENFORCEMENT ACTIONS**

Information required to be disclosed in this section is incorporated herein by reference from Note 13 to the financial statements, "Regulatory Enforcement Matters," and Note 14 to the financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

## **DESCRIPTION OF CAPITAL STRUCTURE**

Information required to be disclosed in this section is incorporated herein by reference from Note 8 to the financial statements, "Shareholders' Equity," included in this annual report to shareholders.

## **DESCRIPTION OF LIABILITIES**

The description of debt outstanding required to be disclosed in this section is incorporated herein by reference from Note 7 to the financial statements, "Note Payable to AgBank," included in this annual report to shareholders.

The description of advance conditional payments is incorporated herein by reference to Note 2 to the financial statements, "Summary of Significant Accounting Policies," to the financial statements, included in this annual report to shareholders.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Note 14 included in this annual report to shareholders.

## **SELECTED FINANCIAL DATA**

The selected financial data for the five years ended December 31, 2010, required to be disclosed in this section is incorporated herein by reference from the "Five-Year Summary of Selected Consolidated Financial Data," included in this annual report to shareholders.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

"Management's Discussion and Analysis," which appears within this annual report to shareholders and is required to be disclosed in this section, is incorporated herein by reference.

## **DIRECTORS AND SENIOR OFFICERS**

The following represents certain information regarding the directors and senior officers of the Association.

### ***DIRECTORS***

Gary Pautler: Chairman of the Board serving a three-year term which expires in 2011 and a member of the Association's Audit Committee and Compensation Committee. Mr. Pautler has been farming since 1967. He is a partner in Pautler Brothers, a family owned irrigated and dryland corn and wheat operation. Mr. Pautler serves as Chairman on the Kit Carson County Planning Commission and is Treasurer of the Stratton Fire Protection District.

Carl Keith James: Vice Chairman of the Board currently serving a three-year term which expires in 2013 and Chairman of the Association's Compensation Committee. Mr. James has been farming since 1973. He has a cow/calf, stocker, wheat, and corn operation. Mr. James serves on the Karval Future Farmers of America advisory committee, the Prairie Conservation District Board, and is Chairman of both the Eastern Slope Rural Telephone Association and Lincoln Community Hospital Boards.

David Aspenson: CPA, Appointed Director currently serving a three-year term which expires in 2011, Vice Chairman of the Association's Audit Committee and a member of the Association's Compensation Committee. Mr. Aspenson is a licensed CPA employed with Kiesling Associates, LLP, an accounting firm specializing in providing financial, tax and consulting services to telecommunications and utility companies. He has been employed with Kiesling since 1984 and is currently the Partner-in-Charge of their Colorado Springs office. He is also the President of Kiesling Investment Management, LLC, an affiliate of Kiesling Associates, LLP that provides money management and insurance services to individuals. Mr. Aspenson is a member of the American Institute of Certified Public Accountants and Colorado and Iowa Societies of Certified Public Accountants and is a registered investment advisor with the National Association of Securities Dealers.

Christopher Bledsoe: Appointed Director currently serving a three-year term which expires in 2012 and Chairman of the Association's Audit Committee. Mr. Bledsoe has been farming and ranching for 36 years. He is a partner in and manager of Bledsoe Livestock Co. LLC, which consists of a cow/calf and yearling operation along with raising dryland wheat, corn and feed. He also has a small domestic elk herd. He is currently serving as a Director of the Flagler Co-Op Board and serves on the Kit Carson County Planning Board.

Robert Boyd: Director currently serving a three-year term which expires in 2012 and a member of the Association's Compensation Committee. Mr. Boyd has been farming and ranching for 38 years and has an irrigated and dryland corn, wheat, sunflower and millet operation. He is part owner in family-owned REM Land, LLC which owns farm ground that is operated by Mr. Boyd and he is also part owner of REM Farms Management, Inc., which is a family-owned farm management consulting business. Mr. Boyd serves on the Arikaree Ground Water Management Board, Lincoln County Weed Advisory Board, the Lincoln County Farm Service Agency County Committee and the Colorado Sunflower Administrative Committee.

Mario Curto: Director currently serving a three-year term which expires in 2013 and a member of the Association's Audit Committee. Mr. Curto has been ranching and farming in Alamosa for 46 years. He is a member/partner in Curto Family Farms, LLC, an alfalfa, oat hay, Coors barley and cow/calf operation. Mr. Curto serves as Secretary of the Alamosa County Fire Protection District Board, is a member of San Luis Valley Well Owners' Board of Directors, is the representative for well owners on the Rio Grande Inter Basin Roundtable and is a member of a committee organized to form a sub-district south and west of Alamosa for the withdrawal of ground water in this area.

Terry James: Director currently serving a three-year term which expires in 2012 and a member of the Association's Audit Committee. Mr. James has been farming and ranching since 1967. He has a cow/calf operation and is a partner in the family owned Dry Creek Ranch which raises corn, wheat and sunflowers. He serves on the Vision Committee for his local church and is a director for the Kit Carson County Farm Bureau.

John Negley: Director currently serving a three-year term which expires in 2011 and Vice Chairman of the Association's Compensation Committee. Mr. Negley has farmed and ranched since 1970. He is a partner in J & L Farms, a family partnership conducting a wheat and cow/calf operation. He serves as Secretary on the Board of Directors for the Kiowa Soil Conservation Board and Secretary for the Eads Hospital Board. He is also a member of the Eads Hospital Executive Board.

Ronald Rehfeld: Director currently serving a three-year term which expires in 2012 and a member of the Association's Compensation Committee. Mr. Rehfeld has farmed and ranched since 1980. He currently operates a cow/calf and dryland wheat, feed and millet operation. He also backgrounds, feeds and direct markets his beef. Mr. Rehfeld is a Board Member of the Colorado Independent Cattle Growers Association and the Cheyenne County Farm Service Agency County Committee.

Jeffrey Uhland: Director currently serving a three-year term which expires in 2012 and a member of the Association's Compensation Committee. Mr. Uhland is a partner with his brothers in Tri-County Farms, which has a dryland crop and trucking operation. He also actively farms with his father and a nephew, raising wheat, milo, corn, sunflowers, and millet. He is a partner in Colorado Mills, LLC, a sunflower oil and feed processing plant in Lamar, Colorado and is also a partner in Mills West, LLC which runs a trucking operation. He serves on the Kiowa County Weed Board and is an alternate on the Sunflower Administrative Committee.

Steven Wertz: Director currently serving a three-year term which expires in 2013 and a member of the Association's Audit Committee. He is the Association representative to the U.S. AgBank Stockholders' Advisory Committee and the Association representative to the U.S. AgBank, FCB District Council. Mr. Wertz has been farming and ranching since 1979. He currently operates a small feedlot and raises irrigated corn and alfalfa. He is a partner in Wertz Bros. LLP Farms which also raises irrigated corn and alfalfa. Mr. Wertz is a board member of the Colorado Corn Growers Administrative Committee and is a member of the Colorado Livestock Association, Colorado Farm Bureau, Colorado Cattlemen's Association, and Colorado Wheat Growers.

Rosalie Martinez: Appointed Director as of December 22, 2010 to fill Douglas Shriver's vacant seat. Her term expires 2011. She is a member of the Association's Compensation Committee. Mrs. Martinez has been engaged in farming and ranching for over 30 years. She is a partner in Rio Vega Ranch, LLC, a cow/calf operation and a partner in Esperanza Farms, LLC, a farming enterprise which raises potatoes, barley and alfalfa. She is also a partner in Sierra Vista Lumber Company, LLC, which includes retail sales in hardware, building supplies, steel and manufactured trusses. She is a partner with her husband in the family businesses: L & M Auto, which includes used car sales, body shop and salvage yard; Re Max Sierra Vista, a real estate company; and the family farm which raises mostly alfalfa. She is retired from Adams State College where she taught in the School of Business and later held the position Associate Vice President for Administration. Rosalie is currently serving as President of the San Luis Valley Regional Medical Center Foundation Board, on the Board of Trustees for the San Luis Valley Regional Medical Center, and on the board of the Boys and Girls Clubs of the San Luis Valley. She also serves on the Honorary Board of the Colorado Women's Hall of Fame and the Adams State College Campus Ministry Committee.

Douglas Shriver: Mr. Shriver was elected to the board in 2008. He served on the board and on the Association's Compensation Committee for two years until his death in March 2010. His three year term would have expired in 2011.

### **SENIOR OFFICERS**

Russell Tomky: President and Chief Executive Officer (CEO) since September 2009. He served as Senior Vice President – Credit from July 2000 to September 2009. Mr. Tomky served as the Senior Vice President of Farm Credit of Colorado Springs FLCA/PCA from March 1994 to June 2000. He also served as the Assistant Vice President – Credit for Farm Credit Services of the Mountain Plains, FLBA/PCA from February 1986 to March 1994. He has been a Farm Credit System employee for twenty-nine years. Mr. Tomky is currently a member of the AgVantis Board of Directors.

Linda Iverson: Chief Operating Officer from January 2005 to present. Ms. Iverson served as the Vice President – Operations from January 2003 to January 2005 and was the Vice President – Administration from July 2000 to January 2003. She also served as the Vice President – Administration for Farm Credit of Colorado Springs, FLCA/PCA from November 1999 through June 2000. She has been with the Farm Credit System for twenty-three years. Ms. Iverson is currently the Acting Chairman of the Supervisory Committee for Aventa Credit Union.

Shawna R. Nepl: Chief Financial Officer since February 2007. Ms. Nepl served as Vice President/Branch Manager of the Colorado Spring Branch from February 2001 to February 2007. She also served as Assistant Vice President – Risk Management from January 2000 to February 2001. She has been with the Farm Credit System for eighteen years.

Rod Uhrig: Chief Credit Officer from November, 2009 to present. Mr. Uhrig served as Vice President – Credit from April 2006 to November 2009. Prior to assuming duties in the Credit Department he was Branch Manager of the Limon Branch and also held management positions with other Farm Credit associations and commercial banks. Mr. Uhrig has been employed with the Farm Credit System for twenty-three years.

David L. Self: Senior Vice President Lending from November 2009 to present. Mr. Self served as the Vice President – Credit from July 2000 to November 2009. Mr. Self has been employed within the Farm Credit System for thirty years.

William A. Barnes: Vice President – Appraisals since December 1993. Mr. Barnes is a Colorado Certified General Appraiser and holds the Accredited Rural Appraiser, (ARA), designation which is awarded by the American Society of Farm Managers and Rural Appraisers, (ASFMRA), to those members who have had years of experience, are technically trained, have passed a rigid examination and subscribe to a high code of ethics. He has held this designation since 1989. He has been with the Farm Credit System for thirty-one years.

### **COMPENSATION OF DIRECTORS AND SENIOR OFFICERS**

Directors of the Association were compensated for services on a per diem basis at the rate of \$500 per day. Chairman of the Board received \$600 per day, and the Vice Chairman of the Board and the Chairman of the Audit Committee received \$550 per day. The Directors were compensated at the rate of \$100 per hour for conference calls. Mileage was compensated at the rate of \$0.50 per mile while on official business.

When Compensation and Audit committee meetings were held in conjunction with the regular board meetings, no additional compensation was paid to the directors for those meetings.

Additional information for each director is provided below:

Name	Number of Days Served at		Compensation for		Compensation Paid During 2010
	Board Meetings	Other Official Activities	Board Meetings And Official Duties	Compensation Committee	
Gary Pautler	12	28	\$ 24,150	\$ 600	\$ 24,750
Carl Keith James	12	13	12,350	550	12,900
David Aspenson	8	8	8,000	–	8,000
Christopher Bledsoe	12	16	15,550	–	15,550
Robert Boyd	12	15	13,000	–	13,000
Mario Curto	12	16	13,500	500	14,000
Terry James	12	15	13,500	–	13,500
John Negley	12	16	13,500	500	14,000
Ronald Rehfeld	12	15	13,500	–	13,500
Jeffrey Uhland	11	17	13,500	500	14,000
Steven Wertz	12	14	13,000	500	13,500
Douglas Shriver	2	8	5,000	–	5,000
<b>Total Compensation</b>			<b>\$ 158,550</b>	<b>\$ 3,150</b>	<b>\$ 161,700</b>

Directors and senior officers are reimbursed for travel, subsistence and other expenses related to Association business according to Association policy. A copy of this policy is available to shareholders upon request. Aggregate reimbursements to directors for travel, subsistence and other related expenses were \$153,236 in 2010, \$116,213 in 2009, \$133,361 in 2008. Noncash compensation paid to directors as a group was \$2,225 during 2010.

Information on senior officers and directors who hold Preferred H-Stock follows. The average dividend rate during 2010 on all balances was 1.00%.

Name of the Account	Director or Officer	Title	December 31, 2010 Balance	Purchases during 2010	Retirements during 2010
Gary Pautler	Gary Pautler	Chairman	\$ 265,383	\$ 8,117	\$ 25,000
Pautler Bros.	Gary Pautler	Chairman	\$ –	\$ 603,321	\$ 596,141
Steven R. Wertz	Steven R. Wertz	Director	\$ 179	\$ 2	\$ –
Carl Keith James	Carl Keith James	Director	\$ –	\$ 92,119	\$ 91,900

Information on chief executive officer (CEO) and senior officer compensation follows. The CEO compensation is not included with the senior officer compensation in accordance with the change in FCA regulations.

CEO Name	Year	Salary	Incentive Compensation	Other*	Total
Russell Tomky	2010	\$ 250,000	\$ 21,437	\$ –	\$ 271,437
Russell Tomky	2009	\$ 63,015	\$ 6,169	\$ 628	\$ 69,812
Barry W. Cooper	2009	\$ 168,951	\$ –	\$ 42,300	\$ 211,251
Barry W. Cooper	2008	\$ 229,676	\$ 74,336	\$ 2,216	\$ 306,228

CEO compensation for Russell Tomky in 2009 includes compensation earned during the time that he served as the Interim President/CEO. Prior to his appointment to this position he was a senior officer and his compensation earned during that time is included in the aggregate officer compensation.

Aggregate Number Of Officers	Year	Salary	Incentive Compensation	Other*	Total
5	2010	\$ 587,086	\$ 50,343	\$ 8,009	\$ 645,438
5	2009	\$ 575,729	\$ 57,753	\$ 5,904	\$ 639,386
5	2008	\$ 529,249	\$ 215,483	\$ 4,551	\$ 749,283

\* Other represents annual leave cash out, service and employee awards.

There was no deferred compensation or perquisite for the years presented.

In addition to base salary, officers can earn additional compensation under an annual variable compensation program, which is tied to the annual business performance of the Association. The variable compensation program is based on a fiscal year and is designed to motivate employees to exceed financial and credit quality performance targets approved by the Board of Directors. These targets typically include credit quality, credit administration, loan volume growth, nonaccrual loan volume, capital, return on assets and other key ratios. While all employees are covered by the incentive plan, the percentage of salary that could be earned varied by level of position during 2008 and 2009. In 2009, market adjustments were made to the maximum payout percentages for most of the job positions. The maximum payout percentages were adjusted in 2010 to provide one maximum payout percentage for loan officers and branch managers that participated in the loan officer incentive program and one maximum payout percentage for all other staff. Annual Incentive Compensation reflects the amount paid for the year earned.

During 2008, loan analysts, loan officers and branch managers were also eligible for a loan officer incentive program. Compensation under this program was tied to new loan volume growth and profitability during the fiscal year that exceeded individualized goals and objectives. This program was suspended in 2009. In 2010 a new loan officer incentive program was implemented that covered loan analysts, loan officers, branch support staff and branch managers. Compensation under this program was tied to new loan volume, loan quality and profitability. These programs were designed to motivate employees to achieve key performance targets approved by the Board of Directors, including loan volume growth, credit quality and return on assets. Annual Incentive Compensation reflects the amount paid for the year earned.

During 2008, all employees were eligible for a discretionary bonus program that was designed to recognize and reward employees for exemplary results or actions. Compensation under this program was at the discretion of the employee's supervisor. Bonuses reflect the amount paid for the year earned. This program was eliminated in 2009.

Disclosure of information on the total compensation paid during the last fiscal year to any senior officer, or to any other officer included in the aggregate, is available to shareholders upon request.

### **TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS**

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section are incorporated herein by reference from Note 12 to the financial statements, "Related Party Transactions," included in this annual report to shareholders.

### **INVOLVEMENT OF SENIOR OFFICERS AND DIRECTORS IN CERTAIN LEGAL PROCEEDINGS**

There were no matters which came to the attention of management or the Board of Directors regarding involvement of senior officers or current directors in specified legal proceedings which are required to be disclosed in this section.

### **BORROWER PRIVACY STATEMENT**

Since 1972, Farm Credit Administration (FCA) regulations have forbidden the directors and employees of Farm Credit institutions from disclosing personal borrower information to others without borrower consent. The Association does not sell or trade customers' personal information to marketing companies or information brokers. Additional information regarding FCA rules governing the disclosure of customer information can be obtained by contacting the Association.

### **RELATIONSHIP WITH INDEPENDENT AUDITORS**

There were no changes in independent auditors since the prior annual report to shareholders and there were no material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

### **RELATIONSHIP WITH U.S. AGBANK, FCB (AGBANK)**

The Association is materially affected by AgBank's financial condition and results of operations. The Association's statutory obligation to borrow from AgBank is discussed in Note 7. Financial assistance agreements between the Association and AgBank are discussed in Note 8. Association requirement to invest in AgBank and AgBank's ability to access capital of the Association is discussed in Note 4 to the financial statements, "Investment in AgBank." AgBank's role in mitigating the Association's exposure to interest rate risk is discussed in the MD&A section – Liquidity.

AgBank is required to distribute its Annual Report to shareholders of the Association if a "significant event," as defined by FCA regulations occurs.

### **FINANCIAL STATEMENTS**

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 16, 2011, and the Report of Management, appearing as part of this annual report to shareholders, are incorporated herein by reference.

### **AGBANK ANNUAL AND QUARTERLY REPORTS TO SHAREHOLDERS**

The shareholders' investment in the Association is materially affected by the financial condition and results of operations of AgBank. Consequently, the Association's annual and quarterly reports should be read in conjunction with AgBank's Annual and Quarterly Reports to Shareholders. Quarterly reports are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. A copy of these reports may be obtained free upon request from the Association. The Association is located at PO Box 9290, 3625 Citadel Drive South, Colorado Springs, Colorado 80909-5355, or may be contacted by calling (719) 570-1087. The reports may also be obtained free of charge by visiting AgBank's website at [www.usagbank.com](http://www.usagbank.com).