

# **2009 Annual Report**



**Progressive Farm Credit  
Services, ACA**

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**AgriBank, FCB's financial condition and results of operations materially affect members' investment in Progressive Farm Credit Services, ACA. To request a free copy of the combined AgriBank, FCB and Affiliated Associations' financial reports contact us at 1116 N. Main Street, Sikeston, Missouri 63801, (573) 471-0342, or via e-mail at [progressivefcs@progressivefcs.com](mailto:progressivefcs@progressivefcs.com) or contact AgriBank, FCB at 375 Jackson Street, St. Paul, MN 55101-1810, (651) 282-8800, or via electronic mail to [AGRIBANKMNM@AGRIBANK.COM](mailto:AGRIBANKMNM@AGRIBANK.COM). The reports are also available through AgriBank, FCB's website at [www.agribank.com](http://www.agribank.com).**

**To request a free copy of Progressive Farm Credit Services' annual or quarterly reports contact us as stated above. The annual report is available on our website 75 days after the end of the calendar year and members are provided a copy of such report 90 days after the end of the year. The quarterly reports are available on our website 40 days after the end of each calendar quarter.**

## CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

Progressive Farm Credit Services, ACA

(Dollars in thousands)

	2009	2008	2007	2006	2005
<b>Statement of Condition Data</b>					
Loans	\$430,280	\$393,211	\$364,642	\$327,735	\$319,174
Allowance for loan losses	986	202	6	--	38
Net loans	429,294	393,009	364,636	327,735	319,136
Investment in AgriBank, FCB	11,353	11,090	11,090	11,090	11,090
Investment securities	12,474	14,803	7,184	1,478	--
Other property owned	210	--	--	--	--
Other assets	12,040	12,292	14,200	12,867	11,451
<b>Total assets</b>	<b>\$465,371</b>	<b>\$431,194</b>	<b>\$397,110</b>	<b>\$353,170</b>	<b>\$341,677</b>
Obligations with maturities of one year or less	\$388,592	\$361,525	\$332,653	\$292,635	\$284,696
<b>Total liabilities</b>	<b>388,592</b>	<b>361,525</b>	<b>332,653</b>	<b>292,635</b>	<b>284,696</b>
Protected members' equity	5	6	6	8	24
Capital stock and participation certificates	1,923	1,841	1,838	1,846	2,045
Unallocated surplus	74,851	67,822	62,613	58,681	54,912
<b>Total members' equity</b>	<b>76,779</b>	<b>69,669</b>	<b>64,457</b>	<b>60,535</b>	<b>56,981</b>
<b>Total liabilities and members' equity</b>	<b>\$465,371</b>	<b>\$431,194</b>	<b>\$397,110</b>	<b>\$353,170</b>	<b>\$341,677</b>
<b>Statement of Income Data</b>					
Net interest income	\$12,785	\$11,756	\$10,924	\$10,030	\$9,608
Provision for (reversal of) loan losses	988	193	2	(44)	35
Patronage income	1,151	1,066	1,248	1,129	1,092
Other expense, net	4,115	4,237	3,680	4,415	3,849
Provision for income taxes	550	174	631	357	218
<b>Net income</b>	<b>\$8,283</b>	<b>\$8,218</b>	<b>\$7,859</b>	<b>\$6,431</b>	<b>\$6,598</b>
<b>Key Financial Ratios</b>					
Return on average assets	1.9%	1.9%	2.0%	1.8%	1.9%
Return on average members' equity	11.4%	12.2%	12.5%	10.9%	11.9%
Net interest income as a percentage of average earning assets	3.1%	2.9%	3.0%	3.0%	2.9%
Members' equity as a percentage of assets	16.5%	16.2%	16.2%	17.1%	16.7%
Net chargeoffs as a percentage of average loans	--	--	--	--	--
Allowance for loan losses as a percentage of loans	0.2%	0.1%	--	--	--
Permanent capital ratio	13.8%	13.1%	13.5%	13.9%	13.7%
Total surplus ratio	13.4%	12.7%	13.0%	13.4%	13.1%
Core surplus ratio	13.2%	12.5%	12.6%	12.6%	12.1%
<b>Other</b>					
Patronage distribution payable to members	\$1,250	\$3,010	\$3,650	\$2,662	\$3,125

The patronage distribution to members accrued for the year ended December 31, 2009 was distributed in cash during the first quarter of 2010. The patronage distributions accrued for the years ended December 31, 2008, 2007, 2006, and 2005 were distributed in cash during the first quarter of each following year. No income was distributed to members in the form of dividends, stock or allocated surplus during these time periods.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Progressive Farm Credit Services, ACA

The following commentary reviews the consolidated financial position and consolidated results of operations of Progressive Farm Credit Services, ACA and its subsidiaries and provides additional specific information. The accompanying consolidated financial statements and notes also contain important information about our financial position and results of operations.

### Forward-Looking Information

This Annual Report includes 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 "anticipate", "believe", "could", "estimate", "may", "should", "will", "expect", or other variations on these terms are intended to identify such forward-looking statements. These statements are based on assumptions and analyses made in light of experience, 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,
- fluctuations in the agricultural, energy, and financing sectors,
- economic conditions and credit performance of our loan portfolio, portfolio growth and seasonal factors,
- changes in our estimates underlying the allowance for loan losses,
- periodically occurring weather-related conditions and plant and animal disease that impact agricultural productivity and income and consumer demand,
- changes in United States government support of the agricultural industry, and
- bio-terrorism and other terrorism.

### Loan Portfolio

Loan volume totaled \$430.3 million at December 31, 2009. The changes in loan volume for the last two years were as follows (in thousands):

Change in loan volume	2009 vs. 2008		2008 vs. 2007	
Accrual				
Mortgage	\$18,213	8.5%	\$5,058	2.4%
Commercial	16,898	9.6%	22,001	14.2%
Nonaccrual	1,958	127.4%	1,510	5592.6%
Total loans	\$37,069	9.4%	\$28,569	7.8%

Our focus on customer satisfaction, marketing, and higher than anticipated new money in both the mortgage and commercial loan portfolios resulted in growth in loan volume during 2009.

### Portfolio Distribution

We are chartered to serve certain counties in Missouri. Approximately 82.9% of our total loan portfolio was in Butler, Cape Girardeau, Dunklin, Mississippi, New Madrid, Scott and Stoddard counties at December 31, 2009.

The commercial loan portfolio shows some seasonality. These loans are normally at their lowest levels during the winter months because of operating repayments following harvest. They then increase throughout the year as farmers borrow for operating and capital needs.

### Financial Market Volatility

During 2009, the severe stress in the financial markets began to stabilize. Throughout this period of financial market volatility, we were able to access the debt capital markets across the yield curve to support the District mission of providing credit to farmers, ranchers and other eligible borrowers. This access enabled us to maintain appropriate levels of liquidity and a conservative asset/liability risk profile while continuing to offer a full array of loan products to our Associations. Associations throughout this period took many actions, including adjusting loan structures and payment terms, and in cases where it was reflective of credit risk, increased pricing to customers.

### Agricultural and Economic Conditions

The Food, Conservation, and Energy Act of 2008 (FCEA/farm bill) was enacted into law in June 2008. FCEA includes significant federal financial support for wheat, feed grains, cotton, rice, oilseeds and dairy, largely continuing the same total level of financial support to agriculture, while changing the distribution and methods of allocating such support. FCEA also contains new, expanded assistance to certain specialty crops, and added price support and trade protection for domestically produced sugar. FCEA continues the direct payment, loan rate and countercyclical payments (CCP) programs from previous farm support legislation, but the levels of support provided by each program have changed. Such support may be unable to cover operating losses due to the dramatic changes in commodity prices for inputs as well as outputs. Also, FCEA provides a new income support program called Average Crop Revenue Election (ACRE), which provides countercyclical support to farmers of many major commodities and it is based on average statewide farm income of recent years rather than more local average incomes. Enrollment in ACRE is low, however, so at an aggregate level ACRE is not a significant source of farm support. Instead, federal farm support revenue has shifted to subsidized crop insurance programs which, with revenue insurance products, now provide more federal support for farm operations than traditional farm support programs.

Net farm income reached record levels in 2008, but the forecast for 2009 is significantly lower. Strong agricultural economic conditions in 2008 were the result of record high prices for agricultural commodities through the third quarter and the continued positive impact of government programs, but those conditions have changed in 2009. The United States Department of Agriculture ("USDA") now forecasts 2009 net farm income to be \$57.0 billion in 2009, down \$30.0 billion (34.5%) from 2008. Although dramatically lower than 2008, 2009 will still likely rank as the 8th highest net farm income year in American farm history. Crop income is estimated to drop by \$18 billion, the largest drop in crop income in recent history. Net cash income, which is a better measure of farmers' ability to service or repay loans, is estimated at \$69.8 billion in 2009, down \$27.7 billion (28.4%) from 2008, and \$1.8 billion below its 10-year average of \$71.6 billion. Net cash income is projected to decline less than net farm income in part because net cash income reflects the sale of \$1.0 billion in carryover stocks from 2008. Net farm income reflects only the earnings from production that occurred in the current year.

A wet spring delayed or prevented some planting of corn and cotton, resulting in an increase of soybean acres. A cooler summer and timely showers helped those late-planted crops. The harvest season was hampered with frequent rain affecting some cotton and rice yields and

pushing back ginning of cotton. Other crops appear to have overcome most adverse conditions for "average" to "above average" yields.

2009 commodity prices were significantly below 2008 but remained above historical levels. However, input costs have also been above historical averages. Market interest rates have remained relatively low throughout the year; however, rates are expected to rise as the economy recovers and efforts to fend off inflation are implemented.

Ongoing stress in the bio-fuel industry resulted in downgrading of most bio-fuel related loans in the portfolio, including \$459 thousand in provision for loan losses recorded during 2009 related to specific bio-fuel credits. Concerns over the ethanol industry continue to be high as most plants continue to struggle to overcome past challenges while others have been shut down.

### Analysis of Risk

The following table summarizes risk assets (accruing volume includes accrued interest receivable) and delinquency information (in thousands):

As of December 31	2009	2008	2007
Loans:			
Accruing restructured	\$ --	\$ --	\$ --
Past due 90 days or more still accruing	911	1,344	527
Nonaccrual	3,495	1,537	27
Total risk loans	4,406	2,881	554
Other property owned	210	--	--
Total risk assets	\$4,616	\$2,881	\$554
Risk loans			
as a percentage of total loans	1.0%	0.7%	0.1%
Total delinquencies			
as a percentage of total loans	0.4%	0.4%	0.4%

Based on our analysis, all loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

The increase in nonaccrual loans was due mainly to the credit deterioration of two loans with a total unpaid balance of \$3.3 million. While these loans are currently under collateralized and are being closely monitored, management is optimistic that future cash flows will enable these borrowers to improve their debt situation. Despite the increase in nonaccrual loans, total risk loans as a percentage of total loans remains within our established risk management guidelines. The volume of nonaccrual loans remained at an acceptable level at December 31, 2009, and represented less than 0.8% of our total portfolio. At December 31, 2009, 95.5% of our nonaccrual loans were current.

In late 2009, we transferred one nonaccrual loan asset to acquired property in the amount of \$210 thousand, which represented our interest in the ethanol related loan.

The credit quality of our portfolio declined somewhat during 2009. Adversely classified assets increased from 2.2% of the portfolio at December 31, 2008, to 2.7% of the portfolio at December 31, 2009.

Adversely classified assets are assets we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, we use various government guarantee programs to reduce the risk of loss. At December 31, 2009, \$19.7 million of our loans were, to some level, guaranteed under these government programs.

### Analysis of the Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on the periodic evaluation of factors such as:

- loan loss history,
- portfolio quality, and
- current economic and environmental conditions.

Comparative allowance coverage of various loan categories follows:

As of December 31	2009	2008	2007
Allowance as a percentage of:			
Loans	0.2%	0.1%	--
Nonaccrual loans	28.2%	13.1%	22.2%
Total risk loans	22.4%	7.0%	1.1%
Net chargeoffs as a percentage of average loans			
	--	--	--
Adverse assets to risk funds	17.8%	14.8%	12.1%

The increase in our allowance for loan losses was a result of funding specific reserves on two loans with a total volume of \$3.3 million. In our opinion, the allowance for loan losses was reasonable in relation to the probable losses in the loan portfolio at December 31, 2009.

### Young, Beginning and Small Farmers and Ranchers

We have specific programs in place to serve the credit and related needs of young, beginning and small farmers and ranchers in our territory. The definitions of young, beginning and small farmers and ranchers follow:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the loan transaction date.
  - A loan to a "young" or "beginning" borrower qualifies if the young or beginning borrower is obligated on the note or is an owner of the closely held entity financed. A loan to a publicly held entity or other entity that is not closely held does not qualify.
- Small: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250 thousand in annual gross sales of agricultural or aquatic products.

### Demographics

Based on the USDA 2002 Census of Agriculture, 6.36% of the farmers in our 12 county territory are young farmers (up to age 34); 25.96% of the farmers in the territory are beginning farmers (up to 9 years 'on the present farm'); and 85.70% of the farms are small farms (\$1,000 to \$249,000 gross farm income).

The USDA Census definitions are in parentheses above. Please note that the USDA Census definitions do not exactly match the accepted YBS definitions widely used in the Farm Credit System as listed in the previous section and therefore the Census percentages are not necessarily comparable to the associations' percentages.

## Mission Statement

Young, beginning and small farmers, ranchers and producers or harvesters of aquatic products are valued customers of our Association. It is our mission to provide sound and constructive credit and services to young, beginning and small farmers, ranchers and producers or harvesters of aquatic products to the maximum extent possible consistent with safe and sound business practices and within our risk-bearing capacity.

## Quantitative Goals and Results

Below are the 2009 targets and actual results for our young, beginning and small farmers and ranchers program:

2009 Target	2009 Actual Results
15% by Number	20.0% Young Farmers (all existing)
15% by Number	25.6% Young Farmers (new loans in 2009)
10% by Volume	15.7% Young Farmers (all existing)
15% by Number	21.0% Beginning Farmers (all existing)
15% by Number	28.0% Beginning Farmers (new loans in 2009)
10% by Volume	18.2% Beginning Farmers (all existing)
35% by Number	34.0% Small Farmers (all existing)
35% by Number	28.5% Small Farmers (new loans in 2009)
20% by Volume	13.9% Small Farmers (all existing)

The following tables detail the level of new business generated in 2009 plus the level of business outstanding as of December 31, 2009, both by number of loans and by volume for young and beginning farmers and ranchers:

Young and Beginning Farmers and Ranchers – Gross New Business During The Year				
Number/Volume of Loans				
Category	Number Of Loans	Percent of Total	Volume Outstanding	Percent of Total
1. Total gross new loans and commitments made during the year	1,455	100.0%	\$251,799	100.0%
2. Total loans and commitments made to young farmers and ranchers	372	25.6%	\$52,894	21.0%
3. Total loans and commitments made to beginning farmers and ranchers	408	28.0%	\$63,983	25.4%

Young Beginning Farmers and Ranchers - Number/Volume of Loans Outstanding				
Category	Number of Loans	Percent Total	Volume Outstanding	Percent Total
1. Total loans and commitments outstanding at year end	4,275	100.0%	\$561,307	100.0%
2. Young farmers and ranchers	854	20.0%	88,031	15.7%
3. Beginning farmers and ranchers	897	21.0%	102,135	18.2%

The following tables detail the level of new business generated in 2009 plus the level of business outstanding as of December 31, 2009, both by number of loans and by volume for small farmers and ranchers:

Small Farmers and Ranchers* - Gross New Business by Loan Size				
December 31, 2009				
Number/Volume Outstanding	\$0 to \$50,000	\$50,001 to 100,000	\$100,001 to 250,000	\$250,001 and greater
Total number of new loans and commitments made during 2009	641	252	271	291
Total number of loans made to small farmers and ranchers during 2009	286	73	47	8
Percentage	44.6%	29.0%	17.3%	2.8%
Total gross loan volume of all new loans and commitments made during 2008	\$15,515	\$19,001	\$44,664	\$172,619
Total gross loan volume to small farmers and ranchers	\$5,723	\$5,438	\$7,008	\$3,935
Percentage	36.9%	28.6%	15.7%	2.3%

\* Less than \$250,000 in annual gross sales.

Small Farmers and Ranchers*- Number/Volume of Loans Outstanding by Loan Size				
Number/Volume Outstanding	\$0 - \$50,000	\$50,001 - \$100,000	\$100,001 - \$250,000	\$250,001 and greater
1. Total number of loans and commitments outstanding at year end	2,125	767	773	610
2. Total number of loans to small farmers and ranchers	984	263	164	44
3. Number of loans to small farmers and ranchers as a % of total number of loans (line 2 / line 1 * 100 = 0.00%)	46.3%	34.3%	21.2%	7.2%
4. Total loan volume outstanding at year end	\$43,917	\$55,981	\$124,245	\$337,164
5. Total loan volume to small farmers and ranchers	\$17,171	\$18,893	\$24,656	\$17,547
6. Loan volume to small farmers and ranchers as a % of total loan volume (line 5 / line 4 * 100 = 0.00%)	39.1%	33.7%	19.8%	5.2%

\* Less than \$250,000 in annual gross sales.

## Qualitative Goals and Outreach Programs

We set the following three qualitative goals for 2009:

- Offer related services either directly or in coordination with others that are responsive to the needs of the YBS farmers and ranchers in the territory,
- Take full advantage of opportunities for coordinating credit and services offered with other Farm Credit 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, and
- Implement effective outreach programs to attract YBS farmers and ranchers, which may include the use of advertising campaigns and educational credit and services programs beneficial to YBS farmers and ranchers in the territory, as well as an advisory committee comprised of YBS farmers and ranchers to provide views on how the credit and services of the direct lender association could best serve the credit and services needs of YBS farmers and ranchers.

Based on our goals for the young, beginning and small farmers and ranchers program, the results were as follows:

- Sponsored meetings to educate YBS farmers on crop marketing techniques including futures and options.
- Sponsored meetings to educate YBS farmers on crop insurance services.
- Sponsored meetings tailored to educate YBS farmers on how to join marketing techniques with crop insurance services.
- Offered crop protection insurance and life insurance to YBS farmers and discussed the benefits with them individually, in meetings and via radio advertising.
- Met with YBS farmers to show them the support that could be made by using FSA 90/10 guarantees.
- Helped YBS farmers obtain lower interest loans using the BIG Missouri linked deposit program.
- Shared Farm Financial Checkup results with borrowers.
- Met with FSA to obtain information to provide to young farmers on programs that would benefit them, including guarantee and subordination programs.
- Counseled YBS farmers in the office on good financial practices.
- Ran ads on radio stations pertaining to YBS programs.
- Ran ads to promote the association's irrigation and grain bin loan programs which resulted in an added interest rate discount for YBS farmers.
- Attended semi-annual meetings on the Three Rivers Junior College Ag Committee to discuss educational needs of Ag students.
- Offered a grant up to \$500 per farmer for up to 8 farmers (one per branch office) for computer and record keeping software.
- Offered a streamlined scorecard approval service for small farmers to significantly reduce paperwork.
- Met with Ag business students from Arkansas State University to conduct a job interview which is a requirement for their class.
- Encouraged YBS farmers to use marketing consultants, scouting services and financial guidance counselors.
- Encouraged YBS farmers to keep adequate financial records and for their accountant to prepare full disclosure year-end financial statements including a Statement of Cash Flows to better analyze and manage their finances.
- Met with Senath and Holcomb school system FFA programs.
- Offered financial and informational support to Southland and Campbell schools.
- Attended Senath FFA officer installation dinner.
- Met with FSA officials to identify YBS farmers that may be able to graduate from FSA and qualify for loans from Progressive FCS.
- Invited FSA loan officer to be special guest speaker at annual customer appreciation dinner to discuss programs and opportunities for YBS farmers.
- Made FSA guaranteed loans with YBS farmers.
- Made FSA subordinated loans to YBS farmers and continued to work with the FSA loan officer on possible new loans for them.

**PARTICIPATED IN VARIOUS SPONSORSHIPS**

- MO Rice Research Field Day
- MO Delta Center Field Day
- Missouri Farm Bureau Foundation for YBS farmers
- Farmers Recognition Banquet for the Charleston & Kelly High School Districts
- Meal for SEMO District Ag Teachers meeting
- Missouri Farm Bureau Foundation golf tournament
- Ag Expo tractor driving contest
- Several high school athletic teams and events
- SEMO district fair 4H & FFA livestock show
- Missouri Angus tour held in SEMO
- Local FFA Chapters for awards
- University of MO corn production meeting

- Southeast Missouri Waterfowl Festival which was targeted at youth

**OTHER ADDITIONAL YOUNG, BEGINNING, SMALL FARMER ACTIVITIES:**

- (Dexter) - Participated in Stoddard County Fair Youth Livestock Auction
- (Jackson) - Judged at local FFA speaking contest
- (Kennett) - Met with Westminster Agri-Business student to discuss internship

**Safety and Soundness of the Program**

In order to provide for extension of sound and constructive credit to young, beginning, and small farmers and ranchers, consistent with our mission statement and business objectives, we set standards and guidelines related to character, capacity, capital and collateral.

The following standards and guidelines applied to our young, beginning and small farmers and ranchers:

YBS Standards and Guidelines		
Character:	Must be satisfactory	(same as regular standard)
Capacity:	115% Capital debt repayment capacity	(same as regular standard)
Capital:	Liquidity: 0% working capital divided by ave. gross income	(vs 15% regular standard)
	Solvency: 40% owners' equity	(vs 50% regular standard)
Collateral:	85% Loan to appraised value for the PCA	(vs 75% regular standard)
	75% Loan to appraised value for the FLCA	(vs 65% regular standard)

As indicated by these standards, primary emphasis will be on the character and capacity standards. Exceptions may be granted if there are offsetting strengths. All terms of repayment or advances will be consistent with our existing lending standards and policy. Obtaining co-signers or guarantors will be encouraged where applicable in order to maintain credit standard, but is not necessarily a requirement. Whenever possible, maximum coordination will occur between us and with governmental and other private sources of credit to provide the best credit package for the customer. Applicants are expected to have the capability to manage and perform at or above average enterprise standards of earnings.

To minimize credit and profit risk exposure when less restrictive minimum credit criteria are required than for other customers, supplemental services or incentives not offered to other customers are available, or qualifying farmers receive preferred interest rates, we have set a maximum portfolio concentration. This maximum portfolio concentration is the total outstanding principal balances of loans to young, beginning and small farmers and ranchers which have one or more exceptions to the core underwriting standards for regular loans (ie, 50% owners' equity, 15% working capital divided by average gross income, 115% capital debt repayment capacity, and 75% loan to appraised value for the PCA or 65% loan to appraised value for the FLCA – as traditionally analyzed, or loans scoring less than 200 if scorecard processed).

Management will ensure that loans made under these programs are identified and reported to the Board quarterly and to AgriBank, FCB annually, or more frequently as required. Such reports will provide a summary of actual results compared to the quantitative and qualitative program targets and goals as set forth in our operational and strategic business plan. Reports on these programs will also be provided to regulatory agencies, as required.

**Additional Loan Information**

Additional loan information is included in Notes 3, 12, 13 and 14.

## Investments Securities

In addition to loans, we hold investments securities. Investments represent our share of securities made up of pools of the guaranteed portion of loans guaranteed by the Small Business Administration. Investments totaled \$12.5 million at December 31, 2009, \$14.8 million at December 31, 2008, and \$7.2 million at December 31, 2007.

The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

## Results of Operations

The following table illustrates profitability information (in thousands):

For the year ended December 31	2009	2008	2007
Net income	<b>\$8,283</b>	\$8,218	\$7,859
Return on average assets	<b>1.9%</b>	1.9%	2.0%
Return on average members' equity	<b>11.4%</b>	12.2%	12.5%

Changes in these ratios relate directly to:

- changes in income as discussed below,
- changes in assets discussed in the Loan Portfolio section, and
- changes in members' equity discussed in the Capital Adequacy section.

The following table summarizes the changes in components of net income (in thousands):

	2009 vs. 2008	2008 vs. 2007
Increase (decrease) in net income	<b>2008</b>	2007
Net interest income	<b>\$1,029</b>	\$832
Provision for loan losses	<b>(795)</b>	(191)
Patronage income	<b>85</b>	(182)
Financially related services and miscellaneous income, net	<b>625</b>	(356)
Operating expenses	<b>(503)</b>	(201)
Provision for income taxes	<b>(376)</b>	457
Total change in net income	<b>\$65</b>	\$359

### Net Interest Income

Net interest income was \$12.8 million for the year ended December 31, 2009. The following table quantifies changes in net interest income (in thousands):

	2009 vs. 2008	2008 vs. 2007
Changes in net interest income due to:	<b>2008</b>	2007
Changes in volume	<b>\$287</b>	\$1,068
Changes in rates	<b>713</b>	(261)
Changes in nonaccrual income and other	<b>29</b>	25
Net change	<b>\$1,029</b>	\$832

Net interest income included income on nonaccrual loans that totaled \$47 thousand in 2009, \$30 thousand in 2008, and \$5 thousand in 2007. Nonaccrual income is recognized when:

- received in cash,
- collection of the recorded investment is fully expected, and
- prior chargeoffs have been recovered.

Net interest margin (net interest income divided by average earning assets) was 3.1% in 2009, 2.9% in 2008, and 3.0% in 2007.

### Provision for Loan Losses

The variance in the provision for loan losses is related to our estimate of possible losses in our portfolio for the applicable years. The increase in 2009 is due to the recording of \$940 thousand of specific reserves for three credits during the year. One of these credits was written down \$209 thousand with the remaining \$210 thousand balance being transferred to acquired property. The remaining two credits have an unpaid balance of \$3.3 million.

### Patronage Income

We received patronage income based on the average balance of our note payable to AgriBank. AgriBank's Board of Directors sets the patronage rate. We recorded patronage income of \$1.1 million in 2009, \$970 thousand in 2008, and \$1.1 million in 2007. Changes in our note payable to AgriBank and patronage rate changes caused the variances in the patronage income amounts. The patronage rates paid by AgriBank were 30 basis points in 2009, 27 basis points in 2008, and 34 basis points in 2007.

We received another component of patronage, referred to as equalization income, from AgriBank. The quarterly average balance of any excess stock investment in AgriBank is used to determine this amount. Additionally, we earn equalization on any stock investment in AgriBank required to be held when our growth exceeds a targeted growth rate. The equalization rate is set by AgriBank's Board of Directors and is targeted at the average cost of funds for all affiliated associations as a group. Equalization income totaled \$62 thousand for 2009, \$96 thousand for 2008, and \$169 thousand for 2007.

### Financially Related Services and Miscellaneous Income, Net

The increase in financially related services and miscellaneous income, net is primarily due to the increase in multi-peril crop insurance fees.

### Operating Expenses

The following presents a comparison of operating expenses by major category and the operating rate (operating expenses as a percentage of average earning assets) for the past three years (in thousands):

For the year ended December 31	2009	2008	2007
Salaries and benefits	<b>\$3,806</b>	\$3,480	\$3,426
Purchased and vendor services	<b>635</b>	617	589
Advertising and promotion	<b>179</b>	163	173
Communications	<b>59</b>	57	53
Occupancy and equipment	<b>448</b>	417	382
Examination	<b>151</b>	142	144
Farm Credit System insurance	<b>753</b>	617	513
Other	<b>273</b>	308	320
Total	<b>\$6,304</b>	\$5,801	\$5,600
Operating rate	<b>1.5%</b>	1.4%	1.5%

The operating expense increases were primarily related to salaries and benefits, occupancy and equipment, and Farm Credit System insurance expense.

### Provision for Income Taxes

We recorded tax expense of \$550 thousand for the year ended December 31, 2009, compared to \$174 thousand for 2008, and \$631 thousand for 2007. Patronage distributions to members reduced our tax liability in 2009, 2008, and 2007. See Note 9 for additional discussion.

## Funding and Liquidity

We borrow from AgriBank under a note payable, in the form of a line of credit, as described in Note 7. During 2009, our average balance was \$363.3 million with an average interest rate of 1.8%. Our average balance during 2008 was \$359.3 million with an average interest rate of 3.4% and during 2007 our average balance was \$317.0 million with an average interest rate of 5.2%. Our other source of lendable funds is from unallocated surplus.

Our approach to sustaining sufficient liquidity to fund operations and meet current obligations is to maintain an adequate line of credit with AgriBank. At December 31, 2009, we had \$166.5 million available under our line of credit. We generally apply excess cash to this line of credit.

We offer variable, fixed, capped, indexed, and adjustable interest rate loans to our borrowers. We determine interest margins charged on each lending program based on:

- cost of funds,
- market conditions, and
- the need to generate sufficient earnings.

The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our interest rate risk.

## Capital Adequacy

Total members' equity increased \$7.1 million during 2009 due to net income for the period and an increase in capital stock and participation certificates outstanding, partially offset by patronage distribution accruals.

Members' equity position information is as follows (in thousands):

As of December 31	2009	2008	2007
Members' equity	<b>\$76,779</b>	\$69,669	\$64,457
Surplus as a percentage of members' equity	<b>97.5%</b>	97.3%	97.1%
Permanent capital ratio	<b>13.8%</b>	13.1%	13.5%
Total surplus ratio	<b>13.4%</b>	12.7%	13.0%
Core surplus ratio	<b>13.2%</b>	12.5%	12.6%

Our capital plan is designed to maintain an adequate amount of surplus and allowance for loan losses which represents our reserve for adversity prior to impairment of stock. We manage our capital to allow us to meet member needs and protect member interests, both now and in the future.

At December 31, 2009, our permanent capital, total surplus, and core surplus ratios significantly exceeded the regulatory minimum requirements. See Note 8 for further discussions of these regulatory ratios.

In addition to these regulatory requirements, we establish an optimum permanent capital target. This target allows us to maintain a capital base adequate for future growth and investment in new products and services. The target is subject to revision as circumstances change. As of December 31, 2009, our optimum permanent capital target was 13%.

The changes in our capital ratios reflect changes in capital and assets. Refer to the Loan Portfolio section for further discussion of the changes in assets. Additional members' equity information is included in Note 8.

In December 2008, the Board of Directors changed the methodology determining the amount of patronage to be distributed, beginning with the 2009 year, whereby the Board of Directors shall determine in December of the plan year the amount of patronage to be distributed for that year.

## Initiatives

We are involved in a number of initiatives designed to improve our credit delivery, related services, and marketplace presence.

### Farm Cash Management

We offer Farm Cash Management to our members. Farm Cash Management links members' revolving lines of credit with an AgriBank Investment Bond to optimize members' use of funds.

### Investments for Rural America Pilot Program

We are participating in an Investments for Rural America pilot program authorized during 2006 by the Farm Credit Administration in order to meet the changing needs of agriculture and rural America by making investments that support farmers, ranchers, agribusinesses, and their rural communities and businesses. These investments will help to increase their well-being and prosperity by providing an adequate flow of capital into rural areas. We had \$635 thousand of volume under this pilot program outstanding at December 31, 2009, \$358 thousand of volume outstanding at December 31, 2008, and \$221 thousand of volume outstanding at December 31, 2007.

## Relationship with AgriBank

### Borrowings

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act. Approval from AgriBank is required for us to borrow elsewhere. A General Financing Agreement, as discussed in Note 7, governs this lending relationship.

Cost of funds under the General Financing Agreement includes:

- a marginal cost of debt component,
- a spread component, which includes cost of servicing and bank profit, and
- a risk premium component, if applicable.

In the periods presented, we were not subject to the risk premium component. Effective in 2010, an additional 2.8 basis points has been added to the spread component related to the cost of AgriBank's new liquidity plan. The marginal cost of debt approach simulates match funding the cost of underlying debt with substantially the same terms as the anticipated terms of our loans to borrowers. This methodology substantially protects us from interest rate risk.

### Investment

We are required to invest in AgriBank capital stock as a condition of borrowing. This investment may be in the form of purchased stock or stock representing previously distributed AgriBank surplus. As of December 31, 2009, we were required to maintain a common stock investment equal to 2.5% of the average quarterly balance of our note payable to AgriBank plus an additional 1% on growth that exceeded a targeted rate. AgriBank's current bylaws allow AgriBank to increase the required investment to 4%.

At December 31, 2009, our entire investment in AgriBank consisted of stock representing distributed AgriBank surplus.

### Patronage

We receive patronage based on the annual average daily balance of our note payable to AgriBank, and equalization income based on the quarterly average daily balance of our excess stock investment in AgriBank. AgriBank's Board of Directors sets the level of patronage for each of the following:

- patronage on our note payable with AgriBank, and
- equalization income based on our preferred stock or growth required stock investment in AgriBank.

Beginning in 2009, patronage income on our note payable with AgriBank was received in the form of cash and AgriBank stock.

#### **Purchased Services**

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We purchase various services from AgriBank including certain:

- information systems,
- financial services,
- accounting and reporting services,
- human resource services, and
- retail product processing and support.

The total cost of services we purchased from AgriBank was \$444 thousand in 2009, \$415 thousand in 2008, and \$403 thousand in 2007.

#### **Affect on Members' Investment**

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Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially affect our members' investment. To request a free copy of the combined AgriBank, FCB and Affiliated Associations' financial reports contact us at 1116 N. Main Street, Sikeston, Missouri 63801, (573) 471-0342, or via e-mail at [progressivefcs@progressivefcs.com](mailto:progressivefcs@progressivefcs.com) or contact AgriBank at 375 Jackson Street, St. Paul, MN 55101-1810, (651) 282-8800, or via electronic mail to [AGRIBANKMN@agribank.com](mailto:AGRIBANKMN@agribank.com). The reports are also available through AgriBank's website at [www.agribank.com](http://www.agribank.com).

To request a free copy of Progressive Farm Credit Services' annual or quarterly reports contact us as stated above. The annual report is available on our website 75 days after the end of the calendar year and members are provided a copy of such report 90 days after the end of the year. The quarterly reports are available on our website 40 days after the end of each calendar quarter.

### **Relationship with Other Farm Credit Institutions**

#### **Insight Technology Unit**

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We participate in the Insight Technology Unit with other AgriBank District associations to facilitate the development and maintenance of certain technology systems essential to providing credit to our borrowers. The Insight Technology Unit is governed by representatives of each participating association. The expenses are shared prorata based on the number of loans and leases of each participant.

#### **Investment in Other Farm Credit Institutions**

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We have a relationship with CoBank, ACB which involves purchasing or selling participation interests in loans. As part of this relationship, at December 31, 2009, our required equity investment in CoBank, ACB was \$1 thousand. CoBank, ACB provides direct loan funds to associations in its chartered territory and also makes loans to cooperatives and other eligible borrowers.

# REPORT OF MANAGEMENT

*Progressive Farm Credit Services, ACA*



We prepare the consolidated financial statements of Progressive Farm Credit Services, ACA (the Association) and are responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements, in our opinion, fairly present the financial condition of Progressive Farm Credit Services, ACA. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

To meet our responsibility for reliable financial information, we depend on accounting and internal control systems designed to provide reasonable but not absolute assurance that assets are safeguarded and transactions are properly authorized and recorded. Costs must be reasonable in relation to the benefits derived when designing accounting and internal control systems. Financial operations audits are performed to monitor compliance. PricewaterhouseCoopers LLP, our independent auditors, audit the consolidated financial statements. They also conduct a review of internal controls to the extent necessary to comply with generally accepted auditing standards in the United States of America. The Farm Credit Administration also performs examinations for safety and soundness as well as compliance with applicable laws and regulations.

The Board of Directors has overall responsibility for our system of internal control and financial reporting. The Board of Directors and its Audit Committee consults regularly with us and meets periodically with the independent auditors and other auditors to review the scope and results of their work. The independent auditors have direct access to the Board of Directors, which is composed solely of directors who are not officers or employees of Progressive Farm Credit Services, ACA.

The undersigned certify we have reviewed Progressive Farm Credit Services, ACA's annual report and it has been prepared in accordance with all applicable statutory or regulatory requirements and the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Charles H. Parker  
Chairperson of the Board  
Progressive Farm Credit Services, ACA

Ronald C. Milbach  
Chief Executive Officer  
Progressive Farm Credit Services, ACA

Vernon D. Griffith  
Chief Financial Officer  
Progressive Farm Credit Services, ACA

March 4, 2010

# REPORT OF AUDIT COMMITTEE

## *Progressive Farm Credit Services, ACA*



The consolidated financial statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of the entire Board of Directors of Progressive Farm Credit Services, ACA (the Association). The Audit Committee oversees the scope of the Association's internal audit program, the approval and independence of PricewaterhouseCoopers LLP (PwC) as our independent 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 Audit Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter.

Management is responsible for 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 consolidated financial statements in accordance with generally accepted auditing standards in the United States of America and to issue their report based on their audit. The Audit Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Audit Committee reviewed and discussed the audited consolidated financial statements for the year ended December 31, 2009, with management. The Audit Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards No. 114, *The Auditor's Communication with Those Charged with Governance*, and both PwC and the internal auditors directly provided reports on significant matters to the Audit Committee.

The Audit Committee had discussions with and received written disclosures from PwC confirming its independence. The Audit Committee also reviewed the non-audit services provided by PwC, if any, and concluded these services were not incompatible with maintaining PwC's independence. The Audit Committee discussed with management and PwC such other matters and received such assurances from them as the Audit Committee deemed appropriate.

Based on the foregoing review and discussions, and relying thereon, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements in the Annual Report for the year ended December 31, 2009.



Charles Parker  
Chairperson of the Audit Committee  
Progressive Farm Credit Services, ACA

### **Audit Committee Members**

Charles H. Parker, Chairperson  
Thomas Fisher  
Randy Hulshof  
Edward C. Marshall, III  
Darrell Nichols  
John Robinson  
Mark Yarbro  
Jim Yount

March 4, 2010

**PricewaterhouseCoopers LLP**  
225 South Sixth Street  
Suite 1400  
Minneapolis MN 55402  
Telephone (612) 596 6000  
[www.pwc.com](http://www.pwc.com)

**Report of Independent Auditors**

To the Board of Directors and Members of  
Progressive Farm Credit Services, ACA

In our opinion, the accompanying consolidated statement of condition and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Progressive Farm Credit Services, ACA (the Association) and its subsidiaries at December 31, 2009, 2008 and 2007, and the results of their operations and their 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 4, 2010

# CONSOLIDATED STATEMENT OF CONDITION

Progressive Farm Credit Services, ACA

(Dollars in thousands)

As of December 31	2009	2008	2007
<b>ASSETS</b>			
Loans	\$430,280	\$393,211	\$364,642
Allowance for loan losses	986	202	6
Net loans	429,294	393,009	364,636
Investment in AgriBank, FCB	11,353	11,090	11,090
Investment securities	12,474	14,803	7,184
Accrued interest receivable	6,745	8,565	10,680
Premises and equipment, net	3,095	2,117	1,949
Other property owned	210	--	--
Net deferred income tax asset	227	56	29
Other assets	1,973	1,554	1,542
Total assets	\$465,371	\$431,194	\$397,110
<b>LIABILITIES</b>			
Note payable to AgriBank, FCB	\$381,673	\$352,740	\$322,676
Accrued interest payable	1,693	2,895	4,187
Patronage distribution payable	1,250	3,010	3,650
Other liabilities	3,976	2,880	2,140
Total liabilities	388,592	361,525	332,653
Contingencies			
<b>MEMBERS' EQUITY</b>			
Protected members' equity	5	6	6
Capital stock and participation certificates	1,923	1,841	1,838
Unallocated surplus	74,851	67,822	62,613
Total members' equity	76,779	69,669	64,457
Total liabilities and members' equity	\$465,371	\$431,194	\$397,110

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

## CONSOLIDATED STATEMENT OF INCOME

Progressive Farm Credit Services, ACA

(Dollars in thousands)

Year ended December 31	2009	2008	2007
<b>Interest income</b>	<b>\$19,462</b>	\$23,790	\$27,401
<b>Interest expense</b>	<b>6,677</b>	12,034	16,477
Net interest income	<b>12,785</b>	11,756	10,924
<b>Provision for loan losses</b>	<b>988</b>	193	2
Net interest income after provision for loan losses	<b>11,797</b>	11,563	10,922
<b>Other income</b>			
Patronage income	<b>1,151</b>	1,066	1,248
Financially related services and miscellaneous income, net	<b>2,189</b>	1,564	1,920
Total other income	<b>3,340</b>	2,630	3,168
<b>Operating expense</b>			
Salaries and employee benefits	<b>3,806</b>	3,480	3,426
Other operating expense	<b>2,498</b>	2,321	2,174
Total operating expense	<b>6,304</b>	5,801	5,600
Income before income taxes	<b>8,833</b>	8,392	8,490
<b>Provision for income taxes</b>	<b>550</b>	174	631
Net income	<b>\$8,283</b>	\$8,218	\$7,859

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

## CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

Progressive Farm Credit Services, ACA

(Dollars in thousands)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Total Members' Equity
<b>Balance at December 31, 2006</b>	\$8	\$1,846	\$58,681	\$60,535
Net income	--	--	7,859	7,859
Adoption of new accounting principle (Notes 2 and 9)	--	--	(271)	(271)
Unallocated surplus designated for patronage distributions	--	--	(3,656)	(3,656)
Capital stock/participation certificates issued	--	150	--	150
Capital stock/participation certificates retired	(2)	(158)	--	(160)
<b>Balance at December 31, 2007</b>	6	1,838	62,613	64,457
Net income	--	--	8,218	8,218
Unallocated surplus designated for patronage distributions	--	--	(3,009)	(3,009)
Capital stock/participation certificates issued	--	172	--	172
Capital stock/participation certificates retired	--	(169)	--	(169)
<b>Balance at December 31, 2008</b>	6	1,841	67,822	69,669
Net income	--	--	<b>8,283</b>	<b>8,283</b>
Unallocated surplus designated for patronage distributions	--	--	<b>(1,254)</b>	<b>(1,254)</b>
Capital stock/participation certificates issued	--	<b>183</b>	--	<b>183</b>
Capital stock/participation certificates retired	<b>(1)</b>	<b>(101)</b>	--	<b>(102)</b>
<b>Balance at December 31, 2009</b>	<b>\$5</b>	<b>\$1,923</b>	<b>\$74,851</b>	<b>\$76,779</b>

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

# CONSOLIDATED STATEMENT OF CASH FLOWS

Progressive Farm Credit Services, ACA

(Dollars in thousands)

Year ended December 31	2009	2008	2007
<b>Cash flows from operating activities</b>			
Net income	\$8,283	\$8,218	\$7,859
Adjustments to reconcile net income to cash flows from operating activities:			
Depreciation on premises and equipment	231	223	190
Provision for loan losses	988	193	2
Stock patronage received from AgriBank, FCB	(262)	--	--
Decrease (increase) in accrued interest receivable	1,818	2,036	(1,404)
(Increase) decrease in other assets	(590)	(39)	1
(Decrease) increase in accrued interest payable	(1,202)	(1,292)	77
Increase (decrease) in other liabilities	1,096	740	(495)
Gain on sale of Farm Credit System Financial Assistance Corporation stock	--	--	(964)
(Gain) on sale of premises and equipment	--	(4)	--
Total adjustments	2,079	1,857	(2,593)
Net cash provided by operating activities	10,362	10,075	5,266
<b>Cash flows from investing activities</b>			
Increase in loans, net	(37,392)	(28,421)	(36,810)
Purchases of investment in AgriBank, FCB, net	(1)	--	--
Decrease (increase) in investment securities, net	2,329	(7,619)	(5,706)
Sale of Farm Credit System Financial Assistance Corporation stock	--	--	964
Purchases of premises and equipment, net	(1,209)	(387)	(152)
Net cash used in investing activities	(36,273)	(36,427)	(41,704)
<b>Cash flows from financing activities</b>			
Increase in note payable to AgriBank, FCB, net	28,933	30,064	39,177
Patronage distributions	(3,014)	(3,649)	(2,668)
Capital stock and participation certificates retired, net	(8)	(63)	(71)
Net cash provided by financing activities	25,911	26,352	36,438
Net change in cash	--	--	--
Cash at beginning of year	--	--	--
Cash at end of year	\$ --	\$ --	\$ --
<b>Supplemental schedule of non-cash activities</b>			
Stock financed by loan activities	\$131	\$132	\$108
Stock applied against loan principal	42	66	47
Interest transferred to loans	2	79	32
Loans transferred to other property owned	210	--	--
Decrease in members' equity from the adoption of FIN 48 (Notes 2 and 9)	--	--	(271)
Patronage distributions payable to members	1,250	3,010	3,650
<b>Supplemental information</b>			
Interest paid	\$7,879	\$13,326	\$16,400
Taxes paid	459	191	1,140

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Progressive Farm Credit Services, ACA

## NOTE 1: ORGANIZATION AND OPERATIONS

### Farm Credit System and District

**Farm Credit System Lending Institutions:** The Farm Credit System is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. At December 31, 2009, the Farm Credit System consisted of four Farm Credit Banks, one Agricultural Credit Bank, and 89 associations. AgriBank and its affiliated associations are collectively referred to as the District. At December 31, 2009, the District consisted of seventeen Agricultural Credit Associations that each have wholly-owned Federal Land Credit Association and Production Credit Association subsidiaries. Federal Land Credit Associations are authorized to originate long-term real estate mortgage loans. Production Credit Associations are authorized to originate short-term and intermediate-term loans. Agricultural Credit Associations are authorized to originate long-term real estate mortgage loans and short-term and intermediate-term loans either directly or through their subsidiaries. Associations are also authorized to provide lease financing options for agricultural purposes. AgriBank provides funding to all associations chartered within the District.

Associations are authorized to provide, either directly, or in participation with other lenders, credit and related services to eligible borrowers. Eligible borrowers may include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related service businesses. In addition, associations can participate with other lenders in loans to similar entities. Similar entities are parties that are not eligible for a loan from a Farm Credit System lending institution, but have operations that are functionally similar to the activities of eligible borrowers. Associations are also authorized to purchase and hold certain types of investments.

**Farm Credit System Regulator:** The Farm Credit Administration (FCA) is authorized by Congress to regulate the Farm Credit System banks and associations. We are examined by the FCA and certain association actions are subject to the prior approval of the FCA and/or AgriBank.

**Farm Credit Insurance Fund:** The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is used:

- to insure the timely payment of principal and interest on Farm Credit Systemwide debt obligations,
- to insure the retirement of protected borrower capital at par or stated value, and
- for other specified purposes.

At the discretion of the Insurance Corporation, the Insurance Fund is also available to provide assistance to certain troubled Farm Credit System institutions and for the operating expenses of the Insurance Corporation. Each Farm Credit System bank has been required to pay premiums into the Insurance Fund until the assets in the Insurance Fund equal 2% of the aggregated insured obligations adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments. This percentage of aggregate obligations can be changed by the Insurance Corporation, at its sole discretion, to a percentage it determines to be actuarially sound.

Effective July 1, 2008, the basis for assessing premiums was changed from loans to debt outstanding. Adjustments to debt outstanding are made for nonaccrual loans and impaired investments which are assessed a surcharge and guaranteed loans which are deductions to the premium

base. AgriBank, in turn, assesses the associations premiums each year based on these same factors. Prior to July 1, 2008, the premiums were based on annual average loan principal outstanding and AgriBank assessed the associations' annual premiums based on the average principal outstanding of accrual and nonaccrual loans of the associations.

### Association

Progressive Farm Credit Services, ACA and its subsidiaries, Progressive Farm Credit Services, FLCA and Progressive Farm Credit Services, PCA are lending institutions of the Farm Credit System. We are a member-owned cooperative providing credit and credit-related services to, or for the benefit of, eligible members for qualified agricultural purposes in the counties of Bolinger, Butler, Cape Girardeau, Carter, Dunklin, Mississippi, New Madrid, Pemiscot, Ripley, Scott, Stoddard and Wayne in the state of Missouri.

We borrow from AgriBank and provide financing and related services to our members. Our ACA holds all the stock of the FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans and holds certain types of investments. The PCA makes short-term and intermediate-term loans.

We offer various risk management services, including credit life, term life, credit disability, crop hail, and multi-peril crop insurance for borrowers and those eligible to borrow. We also offer producer education services to our members.

## NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Accounting Principles and Reporting Policies

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. Preparing financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Principles of Consolidation

The consolidated financial statements present the consolidated financial results of Progressive Farm Credit Services, ACA (the parent) and Progressive Farm Credit Services, FLCA and Progressive Farm Credit Services, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

### Significant Accounting Policies

**Loans:** Mortgage loan terms range from 5 to 40 years at origination. Almost all commercial loans are made for agricultural production or operating purposes with original loan terms of 10 years or less.

Loans are carried at their principal amount outstanding. Loan interest is accrued and credited to interest income based upon the daily principal amount outstanding. Loan fees are recorded as an offset to the related origination costs. The net amount of these fees and expenses is not material to the consolidated financial statements taken as a whole.

We place loans in nonaccrual status when:

- principal or interest is delinquent for 90 days or more (unless the loan is well secured and in the process of collection) or
- circumstances indicate that full collection is not expected.

When a loan is placed in nonaccrual status, we reverse accrued interest to the extent principal plus accrued interest before the transfer exceeds the net realizable value of the collateral. Any unpaid interest accrued in a prior year is capitalized to the recorded investment of the loan. Any cash received on nonaccrual loans is applied to reduce the recorded investment in the loan, except in those cases where the collection of the recorded investment is fully expected and the loan does not have any unrecovered prior chargeoffs. Nonaccrual loans may be returned to accrual status when:

- principal and interest are current,
- prior chargeoffs have been recovered,
- the ability of the borrower to fulfill the contractual repayment terms is fully expected, and
- the loan is not classified as doubtful or loss.

**Investment Securities:** We are authorized to purchase and hold certain types of investments. As we have the positive intent and ability to hold these investments to maturity, they have been classified as held-to-maturity and are carried at cost adjusted for the amortization of premiums and accretion of discounts. If an investment is determined to be other-than-temporarily impaired, the impairment loss is taken through earnings in the period of impairment and the amortized cost of the investment is reduced by the amount of impairment.

**Allowance for Loan Losses:** The allowance for loan losses is an estimate of losses on loans in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on periodic evaluation of factors such as:

- loan loss history,
- portfolio quality and concentration, and
- current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually to establish a specific allowance for impaired loans. A loan is impaired when it is probable that all amounts due under the contractual terms of the loan agreement will not be collected. We generally measure impairment based on the net realizable value of the collateral. All risk loans are considered to be impaired loans. Risk loans include:

- nonaccrual loans,
- formally restructured loans, and
- loans that are 90 days or more past due and still accruing.

We record a specific allowance to reduce the carrying amount of the risk loan to the lower of book value or the net realizable value of collateral. When we deem a loan to be uncollectible, we charge the loan principal and prior year(s) accrued interest against the allowance for loan losses. Subsequent recoveries, if any, are added to the allowance for loan losses.

An allowance is recorded for probable and estimable credit losses as of the financial statement date for loans that are not individually assessed as impaired.

Changes in the allowance for loan losses consist of provision activity, recorded as "Provision for loan losses" on the Consolidated Statement of Income, and chargeoffs and recoveries.

**Investment in AgriBank:** Accounting for our investment in AgriBank is on a cost plus allocated equities basis. The investment in AgriBank is in the form of Class P common stock and Class D preferred stock.

**Premises and Equipment:** The carrying amount of premises and equipment is at cost, less accumulated depreciation. Calculation of depreciation is generally on the straight-line method over the estimated useful lives of the assets. Gains or losses on disposition are included in current operating results. Maintenance and repairs are included in operating expense and improvements are capitalized.

**Other Property Owned:** We record other property owned, which consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, at fair value less estimated selling costs. Income and expense from operations and carrying value adjustments are included in "Financially related services and miscellaneous income, net" on the Consolidated Statement of Income.

**Employee Benefit Plans:** The defined contribution plan allows eligible employees to save for their retirement either pre-tax/post-tax or both with an employer match on a percentage of the employee's contributions. For employees hired after December 31, 2006, the defined contribution plan is the only retirement plan available, and we provide benefits under this plan in the form of a fixed percentage of salary contribution in addition to the employer match. Employer contributions are expensed when incurred.

Certain employees participate in the defined benefit retirement plan of the Seventh Farm Credit District. The plan is comprised of two benefit formulas. Effective October 1, 2001, all new benefits-eligible employees participate in the cash balance formula. Employees hired prior to October 1, 2001, were on the final average pay formula. These employees were given a one-time option to convert to the cash balance formula or to remain on a final average pay formula. The District plan utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and the "Entry Age Normal Cost" method for funding purposes. Effective January 1, 2007, the defined benefit retirement plan was closed to new employees.

We also provide certain health insurance benefits to eligible retired employees according to the terms of the benefit plan. Prior to December 1, 2008, retirees were also provided with a life insurance benefit. The anticipated cost of these benefits is accrued during the employees' active service period.

**Income Taxes:** The ACA and PCA accrue federal and state income taxes. Deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. Deferred tax assets are recorded if the deferred tax asset is more likely than not to be realized. If the realization test cannot be met, the deferred tax asset is reduced by a valuation allowance. The expected future tax consequences of uncertain income tax positions are accrued. In 2007, we adopted Financial Accounting Standards Board Interpretation No. 48 – *Accounting for Uncertainty in Income Taxes*. Under the interpretation, the expected future tax consequences of uncertain income tax positions are accrued.

The FLCA is exempt from federal and other taxes to the extent provided in the Farm Credit Act.

**Patronage Program:** We accrue patronage distributions according to a prescribed formula approved by the Board of Directors. We pay the accrued patronage during the first quarter after each subsequent year.

**Statement of Cash Flows:** For purposes of reporting cash flow, cash includes cash on hand.

**Fair Value Measurement:** The Financial Accounting Standards Board (FASB) guidance on "Fair Value Measurements" 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 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:

- quoted prices for similar assets or liabilities in active markets;
- 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;
- inputs that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates, and
- inputs derived principally from or corroborated by observable market data by correlation or other means.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

#### Recently Issued or Adopted Accounting Pronouncements

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

In April 2009, the FASB issued new guidance on investment fair value measurements and impairments. The new guidance was effective for interim periods ending after June 15, 2009, with early application permitted for periods ending after March 15, 2009. We adopted the guidance during the second quarter of 2009. The impact of adoption resulted in additional investment disclosures, but did not have an impact on our financial condition or results of operations.

In May 2009, the FASB issued guidance, "Subsequent Events", which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Under this Standard, subsequent events that arise from conditions that existed at the date of the balance sheet are recognized in the financial statements, while subsequent events that arise from conditions that did not exist as of the balance sheet date are not recognized in the financial statements. The guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was effective for interim or annual periods ending after June 15, 2009.

In June 2009, the FASB issued new guidance, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles." This Codification became the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. This guidance was effective for financial statements issued for interim and annual periods ending after September 15, 2009. This guidance impacted how we refer to guidance in our disclosures but did not have an impact on our financial condition or results of operations.

In December 2008, the FASB issued new guidance that expands the disclosures required in an employer's financial statements about pension and other postretirement benefits plan assets. The disclosures include more details about the categories of plan assets and information regarding fair value measurements. The guidance was effective for fiscal years ending after December 15, 2009. The impact of adoption resulted in additional District level benefit plan disclosures, but did not have an impact on our financial condition or results of operations.

In June 2009, the FASB issued guidance on "Accounting for Transfers of Financial Assets," which amends previous guidance by providing clarification of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The guidance also requires additional disclosure about transfers of financial assets and a transferor's continuing involvement with transferred assets. This guidance is effective as of January 1, 2010. This guidance must be applied to transfers occurring on or after the effective date. Adoption of this guidance is not expected to have a material impact on our financial statements.

#### NOTE 3: LOANS AND INVESTMENT SECURITIES

Loans consisted of the following (in thousands):

As of December 31, 2009	Amount	Percentage
Long-term agricultural mortgage	\$198,498	45.5%
Production	91,794	21.0%
Intermediate term	98,966	22.7%
Farm related	4,898	1.1%
Rural home	865	0.2%
Participations purchased	10,139	2.3%
Marketing and processing	12,800	3.0%
Other	18,280	4.2%
Subtotal	\$436,240	100.0%
Participations sold	(5,960)	
Total	\$430,280	
As of December 31, 2008	Amount	Percentage
Long-term agricultural mortgage	\$180,883	45.4%
Production	82,808	20.8%
Intermediate term	88,386	22.2%
Farm related	5,196	1.3%
Rural home	1,191	0.3%
Participations purchased	11,919	3.0%
Marketing and processing	14,697	3.7%
Other	13,391	3.3%
Subtotal	\$398,471	100.0%
Participations sold	(5,260)	
Total	\$393,211	
As of December 31, 2007	Amount	Percentage
Long-term agricultural mortgage	\$173,347	47.3%
Production	78,328	21.4%
Intermediate term	69,962	19.1%
Farm related	1,986	0.5%
Rural home	1,065	0.3%
Participations purchased	7,522	2.1%
Marketing and processing	16,894	4.6%
Other	17,349	4.7%
Subtotal	\$366,453	100.0%
Participations sold	(1,811)	
Total	\$364,642	

## Participations

We may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration Regulations or General Financing Agreement limitations. The following table presents information regarding participations purchased and/or sold (in thousands):

As of December 31, 2009	Participations	
	Purchased	Sold
Participations purchased from / sold to:		
Other Farm Credit institutions	\$10,139	\$5,960
Total participations purchased/sold	\$10,139	\$5,960

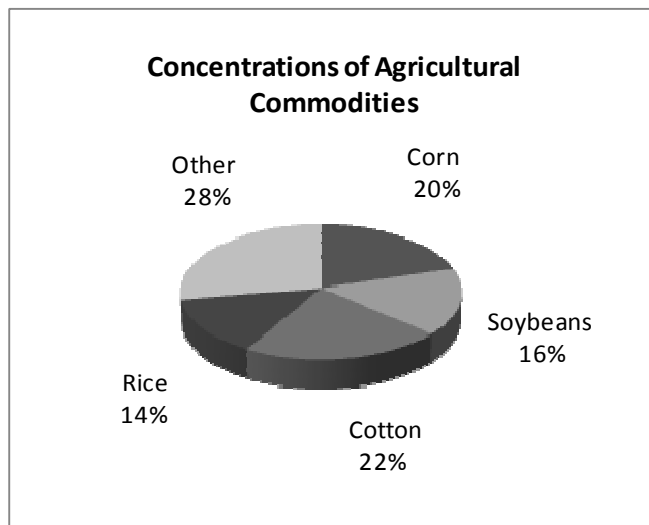
The other participation volume is largely due to participations on loans to agribusinesses.

## Portfolio Concentrations

We have concentrations with individual borrowers, within various agricultural commodities and within our chartered territory.

At December 31, 2009, volume plus commitments to our ten largest borrowers totaled an amount equal to 92.0% of members' equity.

Our agricultural commodity concentrations at December 31, 2009, were as follows:



The commodity concentrations have not changed materially from prior years.

We are chartered to operate in certain counties in Missouri. Approximately 82.9% of our total loan portfolio was in Butler, Cape Girardeau, Dunklin, Mississippi, New Madrid, Scott and Stoddard counties at December 31, 2009.

While these concentrations represent our maximum potential credit risk as it relates to recorded loan principal, a substantial portion of our lending activities is collateralized. This reduces our exposure to credit loss associated with our lending activities. We consider credit risk exposure in establishing the allowance for loan losses.

## Risk Loans

A loan is considered a risk loan if it is probable that we will be unable to collect all principal and interest according to the loan agreement. The following table presents risk loan information (in thousands). Accruing volume includes accrued interest receivable.

As of December 31	2009	2008	2007
Nonaccrual loans:			
Current as to principal and interest	\$3,337	\$1,350	\$27
Past due	158	187	--
Total nonaccrual loans	3,495	1,537	27
Loans past due 90 days or more still accruing	911	1,344	527
Total risk loans	\$4,406	\$2,881	\$554
Volume with specific reserves	\$3,326	\$--	\$--
Volume without specific reserves	1,080	2,881	554
Total risk loans	\$4,406	\$2,881	\$554
Total specific reserves	\$725	\$--	\$--
For the year ended December 31			
Income on accrual risk loans	\$19	\$42	\$35
Income on nonaccrual loans	47	30	5
Total income on risk loans	\$66	\$72	\$40
Average recorded investment	\$2,359	\$1,878	\$428

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at December 31, 2009.

All loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection and, as such, were eligible to remain in accruing status.

## Investment Securities

We hold investment securities consisting of investment securities made up of a portion of loans guaranteed by the Small Business Administration. The securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio. The following table presents the book value, net unrealized gain/loss and fair value of the investment securities (in thousands).

As of December 31	2009	2008	2007
Book value	\$12,474	\$14,803	\$7,184
Net unrealized losses	13	115	356
Estimated fair value	\$12,461	\$14,688	\$6,828
Weighted average yield	3.5%	4.2%	2.9%

Income is recorded in interest income and totaled \$441 thousand in 2009, \$616 thousand in 2008, and \$210 thousand in 2007.

**NOTE 4: ALLOWANCE FOR LOAN LOSSES**

A summary of the changes in the allowance for loan losses follows (in thousands):

For the year ended December 31	2009	2008	2007
Balance at beginning of year	\$202	\$6	\$ --
Provision for loan losses	988	193	2
Loan recoveries	5	3	4
Loan chargeoffs	(209)	--	--
Balance at end of year	<u>\$986</u>	<u>\$202</u>	<u>\$6</u>

The increase in allowance for loan losses is primarily related to the \$725 thousand specific reserves at year end for two credits totaling \$3.3 million.

**NOTE 5: INVESTMENT IN AGRIBANK**

At December 31, 2009, we were required by AgriBank to maintain an investment equal to 2.5% of the average quarterly balance of our note payable to AgriBank plus an additional 1% on growth that exceeded a targeted rate. In addition, beginning in 2009, patronage income on our note payable with AgriBank was received in the form of cash and AgriBank stock.

The following summarizes investment balances (in thousands):

	2009	2008	2007
<b>As of December 31:</b>			
Common stock	\$10,273	\$9,585	\$8,406
Preferred stock	1,080	1,505	2,684
Total investment	<u>\$11,353</u>	<u>\$11,090</u>	<u>\$11,090</u>

**NOTE 6: PREMISES AND EQUIPMENT**

Premises and equipment consisted of the following (in thousands):

As of December 31	2009	2008	2007
Land, buildings and improvements	\$3,706	\$2,441	\$2,438
Furniture and equipment	1,315	1,403	1,106
Subtotal	5,021	3,844	3,544
Less: accumulated depreciation	(1,926)	(1,727)	(1,595)
Total	<u>\$3,095</u>	<u>\$2,117</u>	<u>\$1,949</u>

**NOTE 7: NOTE PAYABLE TO AGRIBANK**

Our note payable to AgriBank represents borrowings, in the form of a line of credit, to fund our loan portfolio. The line of credit is governed by a General Financing Agreement and our assets serve as collateral. The total line of credit was \$500 million and the outstanding principal under the line of credit was \$382 million as of December 31, 2009. The interest rate is adjusted monthly and was 2.0% at December 31, 2009. During 2009, our average balance was \$363 million with an average interest rate of 1.8%. Our average balance during 2008 was \$359.3 million with an average interest rate of 3.4% and during 2007 our average balance was \$317.0 million with an average interest rate of 5.2%. The maturity date is June 30, 2010, for our note payable, at which time the note will be renegotiated.

The General Financing Agreement provides for limitations on our ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2009, and throughout the year, we were within the specified limitations and in compliance with all debt covenants.

**NOTE 8: MEMBERS' EQUITY****Capitalization Requirements**

In accordance with the Farm Credit Act, each borrower is required to invest in us as a condition of obtaining a loan. As authorized by the Agricultural Credit Act and our capital bylaws, the Board of Directors has adopted a capital plan that establishes a stock purchase requirement for obtaining a loan of 2% of the customer's total loan(s) or one thousand dollars, whichever is less. The purchase of one participation certificate is required of all customers to whom a lease is issued and of all non-stockholder customers who purchase financial services. The Board of Directors may increase the amount of required investment to the extent authorized in the capital bylaws. The borrower acquires ownership of the capital stock at the time the loan or lease is made. The aggregate par value of the stock is added to the principal amount of the related obligation. We retain a first lien on the stock or participation certificates owned by customers.

**Protection Mechanisms**

Under the Farm Credit Act, certain borrower equity is protected. We are required to retire protected borrower equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock and participation certificates that were outstanding as of January 6, 1988, or were issued prior to October 6, 1988 as a requirement for obtaining a loan. If an association was unable to retire protected borrower equity at par value or stated value, the Farm Credit Insurance Fund would provide the amounts needed to retire this equity.

**Regulatory Capitalization Requirements**

Under capital adequacy regulations, we are required to maintain a permanent capital ratio of at least 7%, a total surplus ratio of at least 7%, and a core surplus ratio of at least 3.5%. The calculation of these ratios in accordance with Farm Credit Administration Regulations is discussed as follows:

- The permanent capital ratio is average at-risk capital divided by average risk-adjusted assets. At December 31, 2009, our ratio was 13.8%.
- The total surplus ratio is average unallocated surplus less any deductions made in the computation of permanent capital divided by average risk-adjusted assets. At December 31, 2009, our ratio was 13.4%.
- The core surplus ratio is average unallocated surplus less any deductions made in the computation of total surplus and less any preferred stock investment in AgriBank divided by average risk-adjusted assets. At December 31, 2009, our ratio was 13.2%.

We have an agreement with AgriBank which defines how our investment in AgriBank is allocated in calculating regulatory capital ratios. According to the agreement, we include in our ratios all preferred stock which is the amount of our investment in AgriBank that is in excess of the required amount. At December 31, 2009, we included 9.5%, at December 31, 2008, we included 13.6%, and at December 31, 2007, we included 24.2% of our investment in AgriBank as capital. These changes did not have a material impact on our regulatory capital ratios.

## Description of Equities

The following table presents information regarding classes and number of shares of stock and participation certificates outstanding as of December 31, 2009. All shares and participation certificates were \$5.00 par value.

As of December 31, 2009	Shares Outstanding
Class A common stock (protected)	968
Class B common stock (at-risk)	9,395
Class C common stock (at-risk)	370,974
Series 2 participation certificates (at-risk)	4,277

Under our bylaws, we are also authorized to issue Class D common stock, Class E common stock and Class F preferred stock. This stock is at-risk and nonvoting with a \$5.00 par value per share. Currently, no stock of these classes has been issued.

Only holders of Class C stock have voting rights. Our bylaws do not prohibit us from paying dividends on any classes of stock. However, no dividends have been declared during the last three years.

Our bylaws generally permit stock and participation certificates to be retired at the discretion of the Board of Directors and in accordance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2009, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

In the event of our liquidation or dissolution, according to our bylaws, any remaining assets after payment or retirement of all liabilities will be distributed in the following order of priority:

- first, to holders of preferred stock, and
- second, prorate to holders of all classes of common stock and participation certificates.

In the event of impairment, losses will be absorbed in the following priority, first by concurrent impairment of all classes of common stock and participation certificates, then by holders of preferred stock; however, protected stock will be retired at par value regardless of impairment.

All classes of stock are transferable to other customers who are eligible to hold such class as long as we meet the regulatory minimum capital requirements.

## Patronage Distributions

We accrued patronage distributions of \$1.3 million at December 31, 2009, \$3.0 million at December 31, 2008, and \$3.7 million at December 31, 2007. The patronage distributions were paid in cash during the first quarter of each subsequent year. In December 2008, the Board of Directors changed the methodology determining the amount of patronage to be distributed, beginning with the 2009 year, whereby the Board of Directors shall determine in December of the plan year the amount of patronage to be distributed for that year. In December 2009, the Board passed a resolution to distribute patronage refunds in the first month of 2010 in the amount of \$1.3 million based on 2009 net earnings. This amount of the 2009 patronage refund was determined by the Board of Directors subject to all statutory and regulatory requirements.

The Farm Credit Administration Regulations prohibit patronage distributions to the extent they would reduce our permanent capital ratio below the minimum permanent capital adequacy standards. We do not foresee any events that would result in this prohibition in 2010.

## NOTE 9: INCOME TAXES

### Provision for Income Taxes

Our provision for income taxes follows (in thousands):

For the year ended December 31	2009	2008	2007
Current:			
Federal	\$651	\$201	\$551
State	70	--	57
Total current	721	201	608
Deferred:			
Federal	(166)	(28)	29
State	(5)	1	(6)
Total deferred	(171)	(27)	23
Total provision for income taxes	\$550	\$174	\$631
Effective tax rate	6.2%	2.1%	7.4%

The following table quantifies the differences between the provision for income taxes and income taxes at the statutory rates (in thousands):

For the year ended December 31	2009	2008	2007
Federal tax at statutory rate	\$3,003	\$2,853	\$2,887
Net effect of non-taxable entity	(2,036)	(1,643)	(1,061)
State tax, net	33	11	36
Patronage distributions	(425)	(1,023)	(1,241)
Other	(25)	(24)	10
Provision for income taxes	\$550	\$174	\$631

### Deferred Income Taxes

Deferred tax assets and liabilities are composed of the following (in thousands):

As of December 31	2009	2008	2007
Allowance for loan losses	\$140	\$37	\$--
Postretirement benefits accrual	298	302	307
Accrued Incentive	58	--	--
Accrued pension asset	(288)	(275)	(241)
Other liabilities	(7)	(8)	(39)
Other assets	26	--	2
Net deferred income tax assets	\$227	\$56	\$29
Gross deferred tax assets	\$522	\$339	\$309
Gross deferred tax liabilities	(\$295)	(\$283)	(\$280)

A valuation reserve for the deferred tax assets was not necessary at December 31, 2009, December 31, 2008, or December 31, 2007.

We have not provided deferred income taxes on approximately \$10 million of patronage allocations received from AgriBank prior to 1993. Such allocations, distributed in the form of stock, are subject to tax only upon conversion to cash. Our intent is to permanently maintain this investment in AgriBank. With respect to the AgriBank stock distributed in 2002, the Board of Directors has passed a resolution that, should this stock ever be converted to cash, creating a tax liability, an equal amount will be distributed to patrons at that time under the Association's patronage program. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of \$49.3 million as it is our intent to permanently maintain this equity in the FLCA or to distribute the earnings to members in a manner that results in no additional tax liability to us.

We adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48 – *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. Upon adoption of this Interpretation during the first quarter of 2007, we recognized a \$289 thousand increase in the liability for unrecognized tax liabilities which was accounted for as a reduction to the balance of members' equity. The liability for this uncertain tax position was settled by filing amended income tax returns for the applicable periods. The difference between the actual tax liability paid and accrued liabilities resulted in a reversal of \$18 thousand in the third quarter 2007. At December 31, 2009 and December 31, 2008, we had no uncertain income tax positions to recognize.

**NOTE 10: EMPLOYEE BENEFIT PLANS**

**Pension and Post Retirement Benefit Plans**

Complete financial information for the pension and post retirement benefit plans may be found in the AgriBank, FCB and Affiliated Associations 2009 Annual Report.

In December 2007, the District adopted the FASB guidance on "Compensation – Retirement Benefits", which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The FASB guidance on "Compensation – Retirement Benefits" also requires that employers measure the benefit obligation and plan assets as of fiscal year end starting in 2008. The Standard allows for the use of the measurements determined for the prior year-end.

As disclosed in the District Annual Report, the defined benefit plans reflect an unfunded liability totaling \$239.8 million at December 31, 2009. Our individual association increases our prepaid pension asset when contributions are made and reduces our prepaid pension asset as annual expense is recorded. At December 31, 2009 to reflect the \$239.8 million unfunded liability on the District balance sheet, the District reversed the prepaid pension assets and recorded the unfunded position as a liability with an offsetting charge to accumulated other comprehensive income (AOCI). The \$239.8 million unfunded liability represents potential future contributions that may need to be made by the participating employers. The \$332.0 million recorded in AOCI represents potential future expense that may need to be recognized by the participating employers. The amount ultimately to be contributed and the amount ultimately recognized as expense, and the timing of those contributions and expenses, are subject to many variables including performance of plan assets and levels of interest rates. These variables could result in actual contributions and expenses being greater than or less than the amounts reflected in the District financial statements. Based on the District's methodology for allocating expenses and contributions at December 31, 2009, our share of the \$332.0 million potential future expense would be approximately \$4.0 million and our share of the \$239.8 million potential future cash contributions would be \$2.5 million. Please refer to the AgriBank, FCB and Affiliated Associations 2009 Annual Report for detailed disclosures under the FASB guidance on "Compensation – Retirement Benefits".

**Pension:** Certain employees participate in a District-wide multi-employer defined benefit retirement plan (the Plan). The Plan is noncontributory and covers eligible District employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities. Costs are determined for each individual employer based on costs directly related to their current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under the plan. We recognize our proportional share of expense and contribute a proportional share of funding. As a participant in the Plan, we contributed \$360 thousand for 2009, \$396 thousand for 2008, and \$173 thousand for 2007. Plan expenses included in salaries and employee benefits expense in the Consolidated Statement of Income were \$281 thousand for 2009, \$194 thousand for 2008, and \$268 thousand for 2007.

**Life Insurance and Retiree Medical Plans:** District employers also provide certain health insurance benefits to eligible retired employees according to the terms of the benefit plan. Prior to December 1, 2008, retirees were also provided with a life insurance benefit. The anticipated costs of these benefits are accrued during the period of the employee's active status. Postretirement benefits (primarily health care benefits and life insurance) included in salaries and employee benefits expense were \$42 thousand for 2009, \$35 thousand for 2008 and \$53 thousand for 2007.

**Retirement Savings Plan**

We also participate in a retirement savings plan. For employees hired before January 1, 2007, employee contributions are matched dollar for dollar up to 2% and 50 cents on the dollar on the next 4% on both pre-tax and post-tax contributions. The maximum employer match is 4%. For employees hired after December 31, 2006, we contribute 3% of the employee's compensation and will match employee contributions dollar for dollar up to a maximum of 6% on both pre-tax and post-tax contributions. The maximum employer contribution is 9%. Employer contributions under the plan were \$102 thousand in 2009, \$99 thousand in 2008, and \$96 thousand in 2007.

**NOTE 11: RELATED PARTY TRANSACTIONS**

In the ordinary course of business, we may enter into loan transactions with our officers, directors, their immediate family members, and other organizations with which such persons may be associated. Such transactions are subject to special approval requirements contained in Farm Credit Administration 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 other persons. In our opinion, none of these loans outstanding at December 31, 2009, involved more than a normal risk of collectability.

The following table represents information on loans and leases to related parties as determined at each year end (in thousands):

	2009	2008	2007
<b>As of December 31:</b>			
Total related party loans and leases	\$12,528	\$10,602	\$10,318
<b>For the year ended December 31:</b>			
Advances to related parties	\$9,113	\$6,828	\$8,712
Repayments by related parties	7,265	6,361	8,363

The composition of related parties can be different each year end due primarily to changes in the makeup of the Board of Directors. Advances and repayments to related parties at the end of each year are included in the preceding chart.

We purchase various services from AgriBank including certain information systems, certain financial services, certain accounting and reporting services, certain human resource services, and selected retail product processing and support services. The total cost of services we purchased from AgriBank was \$444 thousand in 2009, \$415 thousand in 2008, and \$403 thousand in 2007.

**NOTE 12: CONTINGENCIES AND COMMITMENTS**

In the normal course of business, we have various contingent liabilities and commitments outstanding which may not be reflected in the accompanying consolidated financial statements. We do not anticipate any material losses because of these contingencies or commitments.

From time to time, we may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these consolidated financial statements, we were not aware of any such actions

that would have a material impact on our financial condition. However, such actions could arise in the future.

We have commitments to extend credit to satisfy the financing needs of our borrowers. These financial instruments involve, to varying degrees, elements of credit risk not recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the loan contract. At December 31, 2009, we had commitments to extend credit of \$121.4 million.

Commitments to extend credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements.

#### NOTE 13: FAIR VALUE MEASUREMENTS

The FASB guidance on "Fair Value Measurements and Disclosures" 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 guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. See Note 2 for a more complete description of the three input levels.

#### Non-Recurring Basis

We do not have any assets or liabilities measured at fair value on a recurring basis at December 31, 2009 or December 31, 2008. We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. At December 31, 2008, we had no assets measured at fair value on a non-recurring basis. At December 31, 2009, information on assets measured at fair value on a non-recurring basis is as follows (in thousands):

	Fair Value Measurement Using			Total Fair Value	Total Losses
	Level 1	Level 2	Level 3		
Loans	\$ --	\$ --	\$2,731	\$2,731	\$725
Other property owned	\$ --	\$ --	210	210	210

#### Valuation Techniques

**Loans:** Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. The fair value measurement would fall under level 2 of the hierarchy if the process uses independent appraisals and other market-based information. The fair value measurement would fall under level 3 of the hierarchy if the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral, and other matters. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

**Other Property Owned:** Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

#### NOTE 14: FAIR VALUE OF FINANCIAL INSTRUMENTS

Quoted market prices are generally not available for our financial instruments. Accordingly, we base fair values on:

- judgments regarding future expected losses,
- current economic conditions,
- risk characteristics of various financial instruments,
- credit risk, and
- other factors.

**Loans:** The estimate of the fair value of loan assets is determined by discounting the expected future cash flows using current interest rates. Current interest rates are estimated based on similar loans made or loans repriced to borrowers with similar credit risk. This methodology is used because no active market exists for the vast majority of these loans. Since the discount rates are based upon internal pricing mechanisms and other estimates, we cannot determine whether the fair values presented would equal the exit price negotiated in an actual sale. Furthermore, certain statutory or regulatory factors not considered in the valuation, such as the unique statutory rights of Farm Credit System borrowers, could render our portfolio unmarketable outside the Farm Credit System.

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

Fair value of nonaccrual loans, current as to principal and interest, are discounted with appropriately higher rates, reflecting the uncertainty of continued cash flows. We assume that for noncurrent nonaccrual loans, collection will result only from the sale of the underlying collateral. Fair value is estimated to equal the total net realizable value of the underlying collateral, discounted at an interest rate that appropriately reflects the uncertainty of the expected future cash flows over the average disposal period. We use the legal obligation if the net realizable value of the collateral exceeds the legal obligation for a particular loan.

**Investment Securities:** If an active market exists, the fair value is based on currently quoted market prices. For those securities for which an active market does not exist, we estimate the fair value of these investments by discounting the expected future cash flows using current interest rates.

**Note Payable to AgriBank:** Estimating the fair value of the note payable to AgriBank is determined by segregating the note into pricing pools according to the types and terms of the underlying loans funded. We discount the estimated cash flows from these pools using the current rate charged by AgriBank for additional borrowings with similar characteristics.

**Commitments to extend credit:** Estimating the fair value of commitments to extend credit is determined by the inherent credit loss in such instruments.

The estimated fair value of our financial instruments is as follows (in thousands):

As of December 31, 2009	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Loans, net	\$429,294	\$432,194
Investment securities	12,474	12,461
<b>Financial liabilities:</b>		
Note payable to AgriBank, FCB	\$381,673	\$384,346
<b>Unrecognized financial instruments:</b>		
Commitments to extend credit		(\$152)
As of December 31, 2008	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Loans, net	\$393,009	\$397,647
Investment securities	14,803	14,093
<b>Financial liabilities:</b>		
Note payable to AgriBank, FCB	\$352,740	\$357,806
<b>Unrecognized financial instruments:</b>		
Commitments to extend credit		(\$155)
As of December 31, 2007	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>		
Loans, net	\$364,636	\$365,565
Investment securities	7,184	6,828
<b>Financial liabilities:</b>		
Note payable to AgriBank, FCB	\$322,676	\$323,769
<b>Unrecognized financial instruments:</b>		
Commitments to extend credit		(\$136)

**NOTE 15: FARM CREDIT SYSTEM FINANCIAL ASSISTANCE CORPORATION STOCK SALE**

In January 2007, we sold to AgriBank all Farm Credit System Financial Assistance Corporation stock held by us at 71% of the face value of that stock. Legislation in 1987 required us to purchase this stock to capitalize the Farm Credit System Financial Assistance Corporation. Due to the uncertainty regarding the realization of the asset, the stock had previously been written off and carried at zero book value. The sale resulted in a gain of \$1.0 million in the first quarter 2007. The gain was recorded in "Financially related services and miscellaneous income, net" on the Consolidated Statement of Income. The Financial Assistance Corporation's charter was cancelled as of December 31, 2006.

**NOTE 16: QUARTERLY FINANCIAL INFORMATION (Unaudited)**

Quarterly consolidated results of operations for the years ended December 31, 2009, December 31, 2008 and December 31, 2007, follow (in thousands):

2009	First	Second	Third	Fourth	Total
Net interest income	\$2,741	\$2,948	\$3,502	\$3,594	\$12,785
Provision for (reversal of)					
loan losses	108	214	(1)	667	988
Patronage income	171	187	220	573	1,151
Other expense, net	1,463	1,158	1,365	129	4,115
Provision for income taxes	21	86	251	192	550
Net income	\$1,320	\$1,677	\$2,107	\$3,179	\$8,283
2008	First	Second	Third	Fourth	Total
Net interest income	\$2,733	\$2,753	\$3,210	\$3,060	\$11,756
(Reversal of) provision for					
loan losses	(6)	--	(2)	201	193
Patronage income	233	262	304	267	1,066
Other expense, net	1,262	1,292	835	848	4,237
(Reversal of) provision for					
income taxes	(17)	110	90	(9)	174
Net income	\$1,727	\$1,613	\$2,591	\$2,287	\$8,218
2007	First	Second	Third	Fourth	Total
Net interest income	\$2,476	\$2,705	\$2,998	\$2,745	\$10,924
(Reversal of) provision for					
loan losses	(1)	--	(1)	4	2
Patronage income	221	260	292	475	1,248
Other expense, net	284	1,286	1,248	862	3,680
Provision for income taxes	427	81	98	25	631
Net income	\$1,987	\$1,598	\$1,945	\$2,329	\$7,859

**NOTE 17: SUBSEQUENT EVENTS**

We have evaluated subsequent events through March 4, 2010, which is the date the financial statements were issued.

# DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

Progressive Farm Credit Services, ACA

(Unaudited)

## DESCRIPTION OF BUSINESS

General information regarding the business is discussed in Note 1 of this annual report.

The description of significant business developments, if any, is discussed in the "Management's Discussion and Analysis" portion of this annual report.

## DESCRIPTION OF PROPERTY

The following table sets forth certain information regarding our properties:

Location	Description	Usage
Sikeston, MO	Owned	Headquarters
Sikeston, MO	Owned	Branch
Caruthersville, MO	Owned	Branch
Mississippi County, MO	Owned	Branch
Dexter, MO	Owned	Branch
Jackson, MO	Owned	Branch
Kennett, MO	Owned	Branch
Portageville, MO	Owned	Branch
Poplar Bluff, MO	Owned	Branch

## LEGAL PROCEEDINGS

Information regarding legal proceedings is discussed in Note 12 of this annual report. We were not subject to any enforcement actions at December 31, 2009.

## DESCRIPTION OF CAPITAL STRUCTURE

Information regarding our capital structure is discussed in Note 8 of this annual report.

## DESCRIPTION OF LIABILITIES

Information regarding liabilities is discussed in Note 7 and Note 12 of this annual report.

## SELECTED FINANCIAL DATA

The "Consolidated Five-Year Summary of Selected Financial Data" is presented at the beginning of this annual report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Information regarding any material aspects of our financial condition, changes in financial condition, and results of operations are discussed in the "Management's Discussion and Analysis" portion of this annual report.

## BOARD OF DIRECTORS

Information regarding directors who served as of December 31, 2009, including business experience in the last five years and any other business interest where a director serves on the board of directors or as a senior officer follows:

**Thomas E. Fisher**, Outside Director, is a self-employed grain farmer and Superintendent of the University of Missouri Delta Research Center in Portageville, MO. He also serves as director for the M&A Electric Cooperative, Poplar Bluff, MO, the Pemiscot-Dunklin Electric Cooperative, a rural electric coop, in Kennett, MO, the Pemiscot County Farm Bureau, Caruthersville, MO, a political action group representing the interests of farmers to state and federal legislatures, the Pemiscot County Welfare Commission, Caruthersville, MO, which oversees county welfare programs, and the Pemiscot County Port Authority, Caruthersville, MO, which oversees river transportation issues. His current term on the board began in August, 2007 and expires in August, 2010.

**Randal Hulshof**, is a self-employed grain and cotton farmer. He also serves as a board member for Drainage District #18, a special taxing entity located in Marston, MO. His current term on the board began in August, 2007 and expires in August, 2010.

**Ed Marshall III**, is a self-employed grain farmer. He also serves as a board member for Levee District# 3, a special taxing entity located in Mississippi County. His current term on the board began in August, 2008 and expires in August, 2011.

**Darrell Nichols**, is a self-employed grain farmer. His current term on the board began in August, 2008 and expires in August, 2011.

**Charles H. Parker**, Chairman of the Board, is a self-employed cotton farmer. He also serves as a board member with the Farmers Union Gin Company, a company engaged in custom cotton ginning, in Senath, MO. He also serves as a board member for Harris and Parker Farms, Inc., a farm operation, in Senath, MO, and the Planters Cotton Oil Mill, Inc., a cottonseed crushing company, in Pine Bluff, AR. His current term on the board began in August, 2009 and expires in August, 2012.

**John Robinson**, is a self-employed grain and cotton farmer and a board member of Ditch #37, a special taxing entity located in Dexter, MO and the SEMO Ethanol Coop, an ethanol coop, in Stoddard County. His current term on the board began in August, 2008 and expires in August, 2011.

**Mark Yarbro**, is a self-employed grain farmer. He also serves on the Ozark Border Electric Coop Board, a rural electric coop, in Poplar Bluff, MO. His current term on the board began in August, 2007 and expires in August, 2010.

**James D. Yount**, Vice-Chairman of the Board, is a self-employed grain and livestock farmer, seed dealer and an owner of a crop hail insurance agency. His current term on the board began in August, 2009 and expires in August, 2012.

Pursuant to our bylaws, directors are paid a reasonable amount for attendance at board meetings, committee meetings or other special assignments. Directors are also reimbursed for reasonable expenses incurred in connection with such meetings or assignments. The Board of Directors has adopted a rate of \$350 per day and a per diem rate of \$175 per conference call.

Information regarding compensation for each director who served during 2009 follows:

	Number of Days Served		Compensation paid for service on a board committee	Name of committee	Total Compensation Paid in 2009
	Board Meetings	Other Official Activities			
Fisher, Thomas E.	8	1	\$350	Audit	\$2,975
Hulshof, Randal	11	5	350	Audit	4,950
Marshall III, Ed	11	2	350	Audit	4,200
Nichols, Darrell	11	5	350	Audit	4,950
Parker, Charles H.	10	2	350	Audit	3,850
Robinson, John	10	2	350	Audit	3,850
Yarbro, Mark	9	5	350	Audit	4,250
Yount, James D.	9	5	350	Audit	4,250
<b>Total</b>	<b>79</b>	<b>27</b>	<b>\$2,800</b>		<b>\$33,275</b>

### SENIOR OFFICERS

The senior officers include:

Ronald C. Milbach, Chief Executive Officer (CEO)  
 Robert E. Smith, Chief Credit Officer (CCO)  
 Vernon D. Griffith, Chief Financial Officer (CFO)

Ronald Milbach has been the CEO since April 16, 1991. Robert Smith has served as the CCO since April 1, 1982. Vernon Griffith has been the CFO since November 14, 1991.

Information related to compensation paid to the senior officers is provided in our Annual Meeting Information Statement and is available for inspection at our office locations.

### TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS

Information regarding related party transactions is discussed in Note 11 of this annual report.

### TRAVEL, SUBSISTENCE AND OTHER RELATED EXPENSES

Directors and senior officers are reimbursed for reasonable travel, subsistence and other related expenses associated with business functions. A copy of our policy for reimbursing these costs is available by contacting us at 1116 N. Main Street, Sikeston, Missouri 63801, (573) 471-0342, or via e-mail at [progressivefcs@progressivefcs.com](mailto:progressivefcs@progressivefcs.com).

The total directors' travel, subsistence and other related expenses were \$9 thousand in 2009, \$7 thousand in 2008, and \$14 thousand in 2007.

### INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

No events occurred during the past five years that are material to evaluating the ability or integrity of any person who served as a director or senior officer on January 1, 2010 or at any time during 2009.

### MEMBER PRIVACY

Farm Credit Administration Regulations protect members' nonpublic personal financial information. Our directors and employees are restricted from disclosing information about our association or our members not normally contained in published reports or press releases.

### RELATIONSHIP WITH QUALIFIED PUBLIC ACCOUNTANT

There were no changes in independent auditors since the last annual report to members and we are in agreement with the opinion expressed by the independent auditors. The total fees paid during 2009 were \$20 thousand. The fees paid were for audit services.

### FINANCIAL STATEMENTS

The "Report of Management", "Report of Audit Committee", "Report of Independent Auditors," "Consolidated Financial Statements", and "Notes to Consolidated Financial Statements" are presented prior to this portion of the annual report.

### CREDIT AND SERVICES TO YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS

Information regarding credit and services to young, beginning, and small farmers and ranchers and producers or harvesters of aquatic products is discussed in the "Management's Discussion and Analysis" portion of this annual report.

### EQUAL EMPLOYMENT OPPORTUNITY

We are an equal opportunity employer. It is our policy to provide equal employment opportunity to all persons regardless of race, national origin, religion, age, sex, disability, marital status, veteran status, public assistance status, or any other condition or status covered by law. We comply with all state and local equal employment opportunity regulations. We conduct all personnel decisions and processes relating to our employees and job applicants in an environment free of discrimination and harassment.

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## Progressive Farm Credit Services, ACA

### Funds Held Program

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The Association offers a Funds Held Program ("Funds Held") that provides for customers to make advance payments on designated real estate loans and intermediate term loans. The following terms and conditions apply to all Funds Held unless the loan agreement, or related documents, between the Association and customer provide for other limitations.

#### Payment Application

Loan payments received by the Association before the loan has been billed will normally be placed into Funds Held and applied against the next installment due. Loan payments received after the loan has been billed will be directly applied to the installment due on the loan and related charges, if any. Funds received in excess of the billed amount will be placed into Funds Held unless the customer has specified the funds to be applied as a special or early prepayment of principal.

When a loan installment becomes due, monies in Funds Held for the loan will be automatically applied toward the installment on the due date. Any accrued interest on Funds Held will be applied first. If the balance in Funds Held does not fully satisfy the entire installment, the customer must pay the difference by the installment due date.

#### Account Maximum

The amount in Funds Held may not exceed 50% of the unpaid principal balance of the loan.

#### Interest Rate

Interest will accrue on Funds Held at a simple rate of interest determined by the Association, but may never exceed the interest rate charged on the related loan. The Association may change the interest rate from time to time, and may provide for different rates for different categories of loans. The current interest rate paid on all funds held accounts is equal to the interest rate accruing on the related loan.

Interest rates are currently reported on each customer's year-end loan statement.

#### Withdrawals

The Association may permit borrowers to withdraw funds from a voluntary funds held account, on an exception basis, up to four times per year. The minimum amount that may be withdrawn at any one time is limited to the lesser of \$500 or the balance remaining in the funds held account.

Any requests for withdrawal of funds must be submitted for Association approval.

#### Association Options

In the event of default on any loan, or if Funds Held exceeds the maximum limit as established above, or if the Association discontinues its Funds Held program, the Association may apply funds in the account to the unpaid loan balance and other amounts due, and shall return any excess funds to the customer.

#### Uninsured Account

Funds Held is not a depository account and is not insured. In the event of Association liquidation, customers having balances in Funds Held shall be notified according to regulations.

#### Questions

Please direct any questions regarding Funds Held to your local FCS representative.

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