

LONE STAR, ACA

2010
Quarterly Report
First Quarter



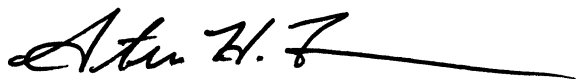
For the Quarter Ended March 31, 2010

REPORT OF MANAGEMENT

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Lone Star Ag Credit Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The audit committee has oversight responsibility for the Association's systems of internal control and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditors to review the scope and results of their work. The independent auditors and the internal auditor have direct access to the audit committee.

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




Steve Fowlkes, Chief Executive Officer

May 10, 2010



Bruce Duncan, Chairman, Board of Directors

May 10, 2010



M'Lissa Kiel, Chief Financial Officer

May 10, 2010



Don Crawford, Audit Committee

May 10, 2010

LONE STAR, ACA
MANAGEMENT'S DISCUSSION AND ANALYSIS

(dollars in thousands unless otherwise noted)

The following commentary reviews the financial performance of the Lone Star, ACA (Agricultural Credit association), referred to as the association, for the quarter and three months ended March 31, 2010. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2009 Annual Report of the association.

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

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the association's audit committee.

Significant Events:

In 2009, an increase in adverse loans and increase in loan loss reserves resulted in a violation of the net earnings and credit quality covenants of the General Financing Agreement ("GFA") between the association and the Farm Credit Bank of Texas ("bank"). The association received a "Notice of Default and Limited Waiver of Certain Requirements in the GFA" from the bank on January 21, 2010, March 5, 2010, and April 28, 2010 stating that the association had committed non-monetary defaults under the agreement. The bank has granted limited waivers of these defaults provided that the association complies with all actions outlined in its response to the Farm Credit Administration (FCA) examination letter dated December 22, 2009.

During the first quarter of 2010 Lone Star, ACA completed a conversion of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed mortgage loans totaling \$59,626 for Agricultural Mortgage-Backed security (AMBS) investments. This transaction is not expected to have a material impact on the financial condition of Lone Star, ACA. See the Note – 2 Investments for more details.

Loan Portfolio:

Total association loans outstanding at March 31, 2010, including principal less funds held were \$1,039,103 compared to \$1,123,923 at December 31, 2009, reflecting a decrease of 7.5 percent. As mentioned previously \$59,626 of this decrease was the conversion of Farmer Mac guaranteed loans to AMBS investments. The additional decrease of \$25,194 is attributed to loan amortizations exceeding loan growth due to decreased demand in real estate, recreational property, and large land tract purchases. Loan volume is expected to continue declining throughout the remainder of 2010 as borrowers continue to reduce debt, adverse loans are collected, and weak economic conditions hinder growth opportunities.

Risk Exposure:

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

	<u>March 31, 2010</u>		<u>December 31, 2009</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 76,917	88.2%	\$ 52,971	82.1%
90 days past due and still accruing interest	1,410	1.6%	-	0.0%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	8,914	10.2%	11,567	17.9%
Total	<u>\$ 87,241</u>	<u>100.0%</u>	<u>\$ 64,538</u>	<u>100.0%</u>

During the first quarter of 2010 the association's high-risk asset portfolio increased as compared to year-end 2009. This increase is primarily attributed to increases in nonaccrual loans from \$52,971 to \$76,917 in December 2009 and March 31, 2010, respectively. Nonaccrual loans as a percentage of total loans outstanding were 7.4 percent at March 31, 2010, compared to 4.7 percent at December 31, 2009, for an increase of \$23,946 or 2.7 percent. The association's credit quality weakened during the first quarter of 2010 due to the downgrade of certain dairy loans to an adverse classification. Dairy loans were downgraded because of unusually high operating losses caused by low prices for milk in 2009 and into the first quarter of 2010. The increase in nonaccrual loans also

relates to deterioration in one loan to a large beef cattle order buying entity. The volatility in the national economy continues to shape a future of uncertainty for the agricultural financial industry. The association will closely monitor its financial performance and adjust operations to ensure profitability and long-term sustainability for the betterment of its stockholders. The decrease in Other Property Owned is attributed to the sale of acquired property and the revaluation of existing acquired property.

Investments:

During the first quarter of 2010 Lone Star, ACA was approved as a Farmer Mac I seller. As a result, the association converted \$59,626 of mortgage loans covered under a Long-Term Standby Commitment to Purchase Agreement with Farmer Mac for guaranteed agricultural mortgage-backed securities. No gain or loss was recognized in the financial statements upon completion of the exchange transaction. The association continues to service the loans included in this transaction. These investments in guaranteed securities are included in this report's Consolidated Balance Sheet as investments – held-to-maturity

Results of Operations:

The association had net loss of \$4,992 for the three months ended March 31, 2010, as compared to net income of \$5,922 for the same period in 2009 reflecting a decrease of 184.3 percent. The decrease in net income stems primarily from an increase in provisions for bad debts of \$9,071, a decrease in loan fees and a decrease in net interest income. Net interest income was \$7,748 for the three months ended March 31, 2010, compared to \$8,186 for the same period in 2009. Interest income for the first three months of 2010 decreased by \$1,700, or 10.3 percent from the same period of 2009 primarily due to a decrease in average loan volume. Interest expense for the first three months of 2010 decreased by \$1,262 or 15 percent, from the same period of 2009 primarily due to a decrease in average debt volume. Average loan volume for the first quarter of 2010 was \$1,111,872 compared to \$1,166,000 in the first quarter of 2009. The average spread on the loan portfolio for the first quarter 2010 was 2.46 percent, and was also 2.46 percent in the first quarter of 2009.

The association recorded \$5 in recoveries and \$1 in charge-offs for the quarter ending March 31, 2010, and \$2 in recoveries and \$181 in charge-offs for the same period in 2009. The association's allowance for loan losses was 1.6 percent and 0.7 percent of total loans outstanding as of March 31, 2010, and December 31, 2009, respectively.

The association's return on average assets for the three months and ending March 31, 2010, was -1.73 compared to 1.97 percent for the same period in 2009. The association's return on average equity for the three months and ending March 31, 2010, was -11.47, compared to 14.48 percent for the same period in 2009. The declining trend of ROA and ROE were primarily attributed to increased provision for loan losses.

Liquidity and Funding Sources:

The association secures the majority of its lendable funds from the bank, which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the association's borrowings.

	March 31, 2010	December 31, 2009
Note payable to the Bank	\$ 955,232	\$ 984,984
Accrued interest on note payable	2,284	2,440
Total	\$ 957,516	\$ 987,424

The decrease of \$29,908 for the three months ended March 31, 2010, is attributable to the decrease in the association's loan volume. The note payable to the bank carried a weighted average interest rate of 2.81 as of March 31, 2010, compared to 2.99 as of December 31, 2009. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the bank and is governed by a financing agreement.

The liquidity policy of the association is to manage cash balances to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2010. As borrower's payments are received they are applied to the association's note payable with the bank.

The association will continue to fund its operations through direct borrowings from the bank, capital surplus from prior years, and borrower stock. It is management's opinion that funds available to the association are sufficient to fund its operations for the current year.

Capital Resources:

The association's capital position decreased by \$5,069 to \$165,583 at March 31, 2010, compared to \$170,683 December 31, 2009. The association's debt as a ratio of members' equity was 5.80:1 as of March 31, 2010, compared to 5.82:1 as of December 31, 2009.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The association's permanent capital ratio at March 31, 2010, was 14.0 percent, which is in compliance with the FCA's minimum permanent capital standard and meets the association's goal. The association's core surplus ratio and total surplus ratio at March 31, 2010, were 13.5 and 13.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard and exceeds the association goal of, equal to or greater than five percent and ten percent, respectively.

Significant Recent Accounting Pronouncements:

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

This guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting standards) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity should apply the transition guidance provided in the pronouncement that requires consolidation. The association reviewed its loan participation agreements to ensure that participations would meet the requirements for sales treatment and there are no special-purpose entities that would require consolidation.

Relationship with the Farm Credit Bank of Texas:

The association's financial condition may be impacted by factors that affect the bank. The financial condition and results of operations of the bank may materially affect the stockholder's investment in the association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2009 Annual Report of Lone Star, ACA more fully describe the association's relationship with the bank.

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

The association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Lone Star ACA, 1612 Summit Ave Suite 300, Fort Worth, TX 76102 or calling (817)332-6565. Copies of the association's quarterly stockholder reports can also be requested by e-mailing Kimberly.Thomas@LoneStarAgCredit.com.

LONE STAR, ACA

CONSOLIDATED BALANCE SHEET

(dollars in thousands)

	March 31, 2010 (unaudited)	December 31, 2009
<u>ASSETS</u>		
Cash	\$ 40	\$ 47
Investments	59,164	-
Loans	1,039,103	1,123,923
Less: allowance for loan losses	<u>(16,461)</u>	<u>(7,386)</u>
Net loans	1,022,642	1,116,537
Accrued interest receivable	10,412	10,501
Investment in and receivable from the Bank:		
Capital stock	20,643	20,643
Other	1,556	2,612
Other property owned, net	8,914	11,567
Premises and equipment	1,622	1,674
Other assets	<u>1,463</u>	<u>371</u>
Total assets	<u><u>\$ 1,126,456</u></u>	<u><u>\$ 1,163,952</u></u>
<u>LIABILITIES</u>		
Note payable to the Bank	\$ 955,232	\$ 984,984
Advance conditional payments	8	14
Accrued interest payable	2,284	2,440
Drafts outstanding	158	132
Other liabilities	<u>3,191</u>	<u>5,699</u>
Total liabilities	<u><u>960,873</u></u>	<u><u>993,269</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	4,640	4,725
Unallocated retained earnings	160,958	165,951
Accumulated other comprehensive income (loss)	<u>(15)</u>	<u>7</u>
Total members' equity	<u><u>165,583</u></u>	<u><u>170,683</u></u>
Total liabilities and members' equity	<u><u>\$ 1,126,456</u></u>	<u><u>\$ 1,163,952</u></u>

LONE STAR, ACA

CONSOLIDATED STATEMENT OF INCOME

(dollars in thousands)
(unaudited)

	Quarter Ended March 31,	
	2010	2009
<u>INTEREST INCOME</u>		
Loans	\$ 14,709	\$ 16,427
Investments	18	-
Total interest income	<u>14,727</u>	<u>16,427</u>
<u>INTEREST EXPENSE</u>		
Note payable to the Bank	6,979	8,241
Advance conditional payments	-	-
Total interest expense	<u>6,979</u>	<u>8,241</u>
Net interest income	7,748	8,186
<u>PROVISION FOR LOSSES</u>		
Provision (negative provision) for loan losses	9,071	442
Provision for acquired property losses	1,617	-
Net impairment loss recognized in earnings	<u>10,688</u>	<u>442</u>
Net interest income (loss) after provision for loan losses	<u>(2,940)</u>	<u>7,744</u>
<u>NONINTEREST INCOME</u>		
Income from the bank:		
Patronage income	512	539
Loan fees	235	971
Financially related services income	43	34
Gain (loss) on other property owned, net	21	(16)
Gain (loss) on sale of premises and equipment, net	-	8
Other noninterest income	40	-
Total noninterest income	<u>851</u>	<u>1,536</u>
<u>NONINTEREST EXPENSES</u>		
Salaries and employee benefits	1,296	1,719
Directors' expense	76	87
Purchased services	472	233
Travel	94	95
Occupancy and equipment	200	165
Communications	48	46
Advertising	66	97
Public and member relations	112	155
Supervisory and exam expense	89	82
Insurance Fund premiums	244	490
Other noninterest expense	206	189
Total noninterest expenses	<u>2,903</u>	<u>3,358</u>
Net income (loss)	<u>\$ (4,992)</u>	<u>\$ 5,922</u>

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

LONE STAR, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(dollars in thousands)

(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2008	\$ 4,753	\$ -	\$ 155,237	\$ 187	\$ 160,177
Net income	-	-	5,922	-	5,922
Amortization of costs included in periodic retirement benefit costs	-	-	-	(25)	(25)
Total comprehensive income	4,753	-	161,159	162	166,074
Capital stock/participation certificates					
Issued	156	-	-	-	156
Retired	(127)	-	-	-	(127)
Other	1	-	(1)	-	-
Balance at March 31, 2009	<u>\$ 4,783</u>	<u>\$ -</u>	<u>\$ 161,158</u>	<u>\$ 162</u>	<u>\$ 166,103</u>
Balance at December 31, 2009	\$ 4,726	\$ -	\$ 165,951	\$ 7	\$ 170,684
Comprehensive income					
Net income	-	-	(4,992)	-	(4,992)
Change in postretirement benefit plans	-	-	-	(23)	(23)
Total comprehensive income	4,726	-	160,959	(16)	165,669
Capital stock/participation certificates					
Issued	61	-	-	-	61
Retired	(147)	-	-	-	(147)
Patronage refunds:					
Cash	-	-	-	-	-
Other	-	-	(1)	1	-
Balance at March 31, 2010	<u>\$ 4,640</u>	<u>\$ -</u>	<u>\$ 160,958</u>	<u>\$ (15)</u>	<u>\$ 165,583</u>

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

LONE STAR, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The association is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The association serves the Hood, Johnson, Somervell, Tarrant, Denton, Wise, Dallas, Bowie, Camp, Cass, Morris, Titus, Delta, Lamar, Red River, Cooke, Fannin, Grayson, Eastland, Erath, Palo Pinto, Parker, Shackelford, Stephens, Throckmorton, Young, Borden, Fisher, Kent, Mitchell, Nolan, Scurry and Taylor in the state of Texas. The association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

Effective January 1, 2010, the bank and related associations adopted Financial Accounting Standards Board (FASB) guidance on “Fair Value Measurements and Disclosures,” which is to improve disclosures about fair value measurements by increasing transparency in financial reporting. The guidance will provide for a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurements. The adoption of this guidance had no impact on the association’s financial condition and results of operations but resulted in additional disclosures.

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

This guidance is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting standards) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity should apply the transition guidance provided in the pronouncement that requires consolidation. The association does not have any variable interest or controlling interest in a variable entity, thus there is no impact of adoption of the guidance.

In June 2009, the FASB also issued guidance to improve financial reporting for those enterprises involved with variable interest entities, which amends previous guidance by requiring an enterprise to perform an analysis to determine whether the enterprise’s variable interest or interests give it a controlling financial interest in a variable interest entity. Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity’s economic performance.

This guidance is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. The association does not have any variable interest or controlling interest in a variable entity, thus there is no impact of adoption of the guidance.

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

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter and the three months ended March 31, 2010, are not necessarily indicative of the results to be expected for the year ended December 31, 2010.

NOTE 2 — Investments:**Mission-related and Other Investments Held-to-Maturity**

A summary of the amortized cost and fair value of mission-related and other investment securities held-to-maturity is as follows:

<u>March 31, 2010</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper, bankers' acceptances, certificates of deposit and other securities	\$ -	\$ -	\$ -	\$ -	0.00%
U.S. Treasury securities	-	-	-	-	0.00%
U.S. agency securities	-	-	-	-	0.00%
Mortgage-backed securities	59,478,775	1,018,911	-	60,497,686	5.22%
Asset-backed securities	-	-	-	-	0.00%
Total	<u>\$ 59,478,775</u>	<u>\$ 1,018,911</u>	<u>\$ -</u>	<u>\$60,497,686</u>	<u>5.22%</u>

<u>December 31, 2009</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper, bankers' acceptances, certificates of deposit and other securities	\$ -	\$ -	\$ -	\$ -	0.00%
U.S. Treasury securities	-	-	-	-	0.00%
U.S. agency securities	-	-	-	-	0.00%
Mortgage-backed securities	-	-	-	-	0.00%
Asset-backed securities	-	-	-	-	0.00%
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>0.00%</u>

The contractual agreement on the held-to-maturity securities is greater than 10 years.

NOTE 3 — ALLOWANCE FOR LOAN LOSSES:

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. An analysis of the allowance for loan losses follows:

	<u>March 31, 2010</u>	<u>March 31, 2009</u>
Balance at beginning of quarter	\$ 7,386	\$ 916
Provision for loan losses	9,071	442
Charge-offs	(1)	(181)
Recoveries	5	2
Balance at end of quarter	<u>\$ 16,461</u>	<u>\$ 1,179</u>

The following table presents information concerning impaired loans:

	March 31, 2010	March 31, 2009
Impaired loans with related allowance	\$ 22,318	\$ 10,676
Impaired loans with no related allowance	55,988	4,676
Total impaired loans	<u>\$ 78,306</u>	<u>\$ 15,352</u>
Allowance on impaired loans	\$ 12,732	\$ 161
Average impaired loans	\$ 57,455	\$ 11,628
Interest income on impaired loans for the quarter	\$ 16	\$ 1

NOTE 4 — CAPITAL:

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

NOTE 5 — INCOME TAXES:

Lone Star, ACA and its subsidiary are subject to federal and certain other income taxes. The associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. No provision for income taxes was recorded as of March 31, 2010.

Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. For the three months ended March 31, 2010, and 2009 the association carries a deferred tax asset of 8,482 and 441 respectively with full valuation allowance recorded against the asset each year.

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

NOTE 6 — FAIR VALUE MEASUREMENTS:

Authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 11 to the 2009 Annual Report to Stockholders for a more complete description.

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

<u>March 31, 2010</u>	<u>Fair Value Measurement Using</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets held in non-qualified benefit trusts	47	-	-
Total assets	<u>47</u>	<u>-</u>	<u>-</u>
<u>December 31, 2009</u>	<u>Fair Value Measurement Using</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets held in non-qualified benefit trusts	35	-	-
Total assets	<u>35</u>	<u>-</u>	<u>-</u>

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

<u>March 31, 2010</u>	<u>Fair Value Measurement Using</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:			
Loans *	\$ -	\$ -	\$ 73,912
Other property owned	-	-	10,956

<u>December 31, 2009</u>	<u>Fair Value Measurement Using</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:			
Loans *	\$ -	\$ -	\$ 43,466
Other property owned	-	-	12,009

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

Valuation Techniques

As more fully discussed in Note 11 to the 2009 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the bank and its related associations' assets and liabilities. For a more complete description, see Notes to the 2009 Annual Report.

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities are classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services, pricing models that utilize observable inputs or discounted cash flows. Generally, these securities are classified as Level 2. This would include certain mortgage-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include asset-backed securities and certain mortgage-backed securities, including those issued by Farmer Mac.

Assets Held in Non-Qualified Benefits Trusts

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

Loans

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

Other Property Owned

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value. Cost to sell represent transaction costs and are not included as a component of the assets fair value.

NOTE 7 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs for the three months ended March 31,

	Other Benefits	
	2010	2009
Service cost	\$ 15	\$ 14
Interest cost	27	25
Amortization of prior service costs	(35)	(35)
Amortizations of net (gain) loss	12	11
Net periodic benefit cost	<u>\$ 19</u>	<u>\$ 15</u>

In September 2006, the FASB issued guidance, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of this guidance were adopted at December 31, 2007. The guidance also required that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, the System used a September 30 measurement date for pension and other postretirement benefit plans. The guidance provided two approaches for an employer to transition to a fiscal year-end measurement date. The System has applied the second approach, which allows for the use of the measurements determined for the prior year end.

The association previously disclosed in its financial statements for the year ended December 31, 2009, that it expected to contribute \$59 to its defined pension plan in 2010. As of March 31, 2010, \$19 of contributions have been made. The association presently anticipates contributing an additional \$40 to fund its defined pension plan in 2010 for a total \$59.

NOTE 8 — Commitments and Contingent Liabilities:

In addition to those commitments and contingencies discussed in Note 2, “Summary of Significant Accounting Policies,” the association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings against the association at this time that are likely to materially affect the association.

In the ordinary course of business the association originates and purchases loan participations with other lenders. These participations present both credit and counterparty risk. As of March 31, 2010, the association had loan participations in the amount of \$43,846 including participations purchased outside the district of \$553 and participations sold of \$14,911.

The association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financing obligations. Standby letters of credit are recorded, at fair value, on the balance sheet by the association. At March 31, 2010, the association had \$573 of standby letters of credit.