

2008
Annual Report



Farm Credit Services of
North Dakota, ACA

2008 ANNUAL REPORT

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Farm Credit Services of North Dakota, ACA

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AgriBank, FCB's financial condition and results of operations materially affect members' investment in Farm Credit Services of North Dakota, ACA. To request a free copy of the combined AgriBank, FCB and Affiliated Associations' financial reports contact us at Post Office Box 70, Minot, North Dakota 58702-0070, (701) 852-1265, or via electronic mail to info@farmcreditnd.com or through our website at www.farmcreditnd.com. You may also contact AgriBank, FCB at 375 Jackson Street, St. Paul, MN 55101-1810, (651) 282-8800, or via electronic mail to AGRIBANKMN@AGRIBANK.COM. The reports are also available through AgriBank, FCB's website at www.agribank.com.

To request a free copy of our 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 40 days after the end of each calendar quarter.

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER



Dear Farm Credit Customer:

While the U.S. and world economies had a tumultuous year in 2008, the agricultural economy fared quite well, especially in North Dakota. This was due to a fair crop year in most areas along with good commodity prices. While farm earnings continued to be strong in 2007 and 2008, the decrease in crop prices late in 2008 will have an effect on future profits. Risk management for farmers will be essential in the coming year as they manage smaller farm earnings.

Farm Credit Services of North Dakota, ACA had an excellent year in 2008. Loan volume increased by \$106.8 million with credit quality remaining strong at 98.4%. Overall earnings were \$11.5 million which is a 64% increase over last year. The increase in earnings was due mainly to multi-peril crop insurance revenue, increased loan volume and fee income. Our net operating rate was 0.15% as compared to 0.97% for the previous year. The permanent capital ratio decreased from 18.8% to 16.8% due to the increase in loan volume.

We were successful this year because of you, the customer. The Pat-NOW philosophy and fever is resulting in more money being placed in your pocket, and we thank you for contributing to our success. The Board of Directors and staff at FCS of North Dakota, ACA are committed to making Pat-NOW one of the primary reasons for you to do your business with us.

Sincerely,



Claude Sem
President and Chief Executive Officer
Farm Credit Services of North Dakota, ACA

February 27, 2009

CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

Farm Credit Services of North Dakota, ACA

(Dollars in thousands)

| | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|-----------|-----------|-----------|-----------|-----------|
| Statement of Condition Data | | | | | |
| Loans | \$554,556 | \$447,792 | \$410,913 | \$380,022 | \$365,417 |
| Allowance for loan losses | 1,433 | 1,216 | 1,277 | 1,175 | 1,234 |
| Net loans | 553,123 | 446,576 | 409,636 | 378,847 | 364,183 |
| Investment in AgriBank, FCB | 11,570 | 9,194 | 9,109 | 9,109 | 9,109 |
| Investment securities | 7,674 | -- | -- | -- | -- |
| Other property owned | 246 | -- | -- | 27 | 178 |
| Other assets | 16,680 | 17,156 | 19,051 | 16,571 | 13,092 |
| Total assets | \$589,293 | \$472,926 | \$437,796 | \$404,554 | \$386,562 |
| Obligations with maturities of one year or less | \$475,588 | \$370,746 | \$342,542 | \$314,529 | \$303,037 |
| Total liabilities | 475,588 | 370,746 | 342,542 | 314,529 | 303,037 |
| Protected members' equity | 4 | 11 | 12 | 20 | 39 |
| Capital stock and participation certificates | 2,073 | 2,002 | 2,067 | 2,089 | 2,136 |
| Unallocated surplus | 111,628 | 100,167 | 93,175 | 87,916 | 81,350 |
| Total members' equity | 113,705 | 102,180 | 95,254 | 90,025 | 83,525 |
| Total liabilities and members' equity | \$589,293 | \$472,926 | \$437,796 | \$404,554 | \$386,562 |
| Statement of Income Data | | | | | |
| Net interest income | \$11,470 | \$10,108 | \$9,041 | \$9,646 | \$9,763 |
| Provision for (reversal of) loan losses | 290 | (67) | 142 | (53) | (5,786) |
| Patronage income | 1,115 | 1,220 | 1,107 | 1,054 | 908 |
| Other expense, net | 688 | 4,071 | 4,664 | 4,366 | 4,114 |
| Provision for (reversal of) income taxes | 146 | 332 | 83 | (179) | 1,642 |
| Net income | \$11,461 | \$6,992 | \$5,259 | \$6,566 | \$10,701 |
| Key Financial Ratios | | | | | |
| Return on average assets | 2.2% | 1.5% | 1.2% | 1.7% | 2.9% |
| Return on average members' equity | 10.7% | 7.1% | 5.7% | 7.6% | 14.2% |
| Net interest income as a percentage of average earning assets | 2.3% | 2.4% | 2.3% | 2.6% | 2.8% |
| Members' equity as a percentage of assets | 19.3% | 21.6% | 21.8% | 22.3% | 21.6% |
| Net chargeoffs as a percentage of average loans | -- | -- | -- | -- | -- |
| Allowance for loan losses as a percentage of loans | 0.3% | 0.3% | 0.3% | 0.3% | 0.3% |
| Permanent capital ratio | 16.8% | 18.8% | 18.7% | 19.6% | 18.4% |
| Total surplus ratio | 16.5% | 18.4% | 18.3% | 19.1% | 17.8% |
| Core surplus ratio | 16.5% | 18.4% | 18.2% | 18.8% | 17.3% |

No income was distributed to members in the form of cash, dividends, stock or allocated surplus during the five years presented.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Farm Credit Services of North Dakota, ACA

The following commentary reviews the consolidated financial position and consolidated results of operations of Farm Credit Services of North Dakota, 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

Certain sections of this Annual Report contain forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. Words such as "anticipates", "believes", "could", "estimates", "may", "should", "will", 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 and general economies,
- 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 \$554.6 million at December 31, 2008. The changes in loan volume for the last two years were as follows (in thousands):

| Change in loan volume | 2008 vs. 2007 | | 2007 vs. 2006 | |
|-----------------------|------------------|--------------|-----------------|-------------|
| Accrual | | | | |
| Mortgage | \$70,241 | 25.2% | \$31,589 | 12.8% |
| Commercial | 33,479 | 20.0% | 6,525 | 4.1% |
| Nonaccrual | 3,044 | 180.2% | (1,235) | (42.2%) |
| Total loans | <u>\$106,764</u> | <u>23.8%</u> | <u>\$36,879</u> | <u>9.0%</u> |

Change in loan volume is the result of loans to new customers, cross selling to our existing customers and an increase in participation volume. Producer input costs were increased in 2008 with fertilizer and fuel having the largest increase. Significant farmer working capital delayed the use of operating funds until later in the farming cycle. Good commodity prices this past year allowed for payments larger than were scheduled on the original loan terms. Oil activity in our western territory created revenue in lease income and oil royalty funds. This did create some advance payment on loans. Demand for machinery and real estate purchases remained strong with new loans made to finance these purchases.

Portfolio Distribution

We are chartered to operate in certain counties in North Dakota, as listed in Note 1 in the accompanying consolidated financial statements. Approximately 37.3% of our total loan portfolio at December 31, 2008 was in the counties of McHenry, McLean, Mountrail, Ward and Wells.

Our portfolio is heavily concentrated in cash grain operations representing approximately 55% of the total portfolio. Accordingly, 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.

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. Also, FCEA provides a new income support program called Average Crop Revenue Election (ACRE).

Strong agricultural economic conditions in 2008 were the result of record high prices for agricultural commodities and the continued positive impact of government programs. The USDA reported \$86.8 billion in net farm income in 2007 representing a significant increase over the reported \$59.0 billion in net farm income in 2006, and 42% higher than the 10-year average net income of \$61.1 billion. Increases in income were due to higher agricultural commodity prices, partially offset by increases in agricultural production costs, including fuel, land, fertilizer and pesticides. Net farm income is forecast to be \$86.9 billion (down from \$96.6 billion previously forecasted) in 2008 but virtually unchanged from 2007. Net cash income, a more critical statistic for lenders, is forecast to be \$90.7 billion in 2008, a \$3.3 billion (4%) increase over 2007 net cash income. Sales of 2007 crops in 2008 account for the larger increase in net cash income compared to the increase in net farm income.

The Farm Credit System (the System) continues to fulfill its mission and be a reliable source of debt capital for the farmers, ranchers and other rural businesses that we serve. However, during the second half of 2008, the culmination of negative economic developments in the global financial markets created a high level of volatility and uncertainty among global financial institutions in general. This volatility has constrained the System's ability to issue debt in the preferred maturities and structures that have traditionally been used to fund our loan portfolios. However, the System has been able to issue debt with a broad enough range of maturities and structures to allow the AgriBank District to continue to offer our complete array of loan products. Responses by the Federal Government, including explicit actions to protect the housing Government Sponsored Entities (GSEs) and to capitalize and guarantee the liabilities of many commercial banks, have had an unintended consequence of increasing our spread over Treasury rates relative to these institutions and reducing our ability to issue debt at preferred maturities and structures. During December 2008 and into January 2009, the spreads to Treasuries have narrowed significantly from levels seen in the fourth quarter of 2008, but still remain "wide" of housing GSE and government guaranteed bank debt. Due to the System's sound financial condition, we expect to continue to issue debt securities as

necessary to meet our funding needs. However, spreads relative to Treasuries and swap rates are expected to remain at higher levels than our historical experience.

Most of our borrowers saw good profitability in 2008; however, those that did not lock in prices saw reductions in profits due to lower commodity prices in the latter part of the year. A delayed corn harvest due to poor dry down and an early snowfall resulted in additional harvesting costs and reduced yields for those producers. Livestock producers have also seen sale prices decline reducing the profitability in that sector. Moisture conditions going into the 2009 spring planting season should be good across most of our territory. Projected prices for commodities have declined somewhat for 2009; however, prices for major inputs such as fertilizer and fuel have also declined which should decrease overall operating costs. Credit quality for traditional ag credit has remained strong; however, we have seen some stress on our commercial portfolio due to issues in the ethanol and protein markets plus downturns in the national and global economies. Land values remain stable with continued good demand for land.

Analysis of Risk

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

| As of December 31 | 2008 | 2007 | 2006 |
|--|---------|---------|---------|
| Loans: | | | |
| Accruing restructured | \$932 | \$986 | \$520 |
| Past due 90 days or more still accruing | 492 | 64 | -- |
| Nonaccrual | 4,733 | 1,689 | 2,924 |
| Total risk loans | 6,157 | 2,739 | 3,444 |
| Other property owned | 246 | -- | -- |
| Total risk assets | \$6,403 | \$2,739 | \$3,444 |
| Risk loans as a percentage of total loans | 1.1% | 0.6% | 0.8% |
| Total delinquencies as a percentage of total loans | 0.4% | 0.2% | 0.5% |

Based on our analysis, loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection.

The volume of nonaccrual loans remained at an acceptable level at December 31, 2008, and represented 0.8% of our total portfolio. The increase in nonaccrual loans is primarily from the transfer of two accounts involved in the ethanol and protein markets to nonaccrual status in December 2008. At December 31, 2008, 84.3% of our nonaccrual loans were current.

The credit quality of our portfolio declined slightly during 2008. Adversely classified assets increased from 0.9% of the portfolio at December 31, 2007, to 1.6% of the portfolio at December 31, 2008. 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, 2008, \$37.5 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 | 2008 | 2007 | 2006 |
|---|-------|-------|-------|
| Allowance as a percentage of: | | | |
| Loans | 0.3% | 0.3% | 0.3% |
| Nonaccrual loans | 30.3% | 72.0% | 43.7% |
| Total risk loans | 23.3% | 44.4% | 37.1% |
| Net chargeoffs as a percentage of average loans | | | |
| | -- | -- | -- |
| Adverse assets to risk funds | 9.0% | 4.4% | 8.3% |

In our opinion, the allowance for loan losses was reasonable in relation to the probable losses in the loan portfolio at December 31, 2008. The changes in ratios from 2007 to 2008 reflect the increase in risk assets, primarily from the transfer of two accounts involved in the ethanol and protein markets to nonaccrual status in December 2008.

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.
- 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.

The demographics of the young, beginning and small farmers in our territory were compiled from the 2002 USDA Ag-Census. At the time of the census there were 9,704 farmers in Farm Credit Services of North Dakota, ACA's territory which was a decrease of 8.5% from the 1997 USDA Ag-Census. There were 8,845 small farmers in our territory. This was 9.0% less than the 1997 Ag-Census. There were 1,796 beginning farmers. This was 3.2% less than the 1997 Ag-Census. Young farmers had a 39.2% decline with 729 in our territory.

Our mission statement for the Young, Beginning and Small Farmers program is "to assist young, beginning and small farmers and ranchers to succeed in business in their agricultural environment." The specific means to meet the objective of this mission statement follows:

- Our volume goal for young farmers is \$113.9 million which is 110% of risk funds. At December 31, 2008, we had \$100.7 million in loans to young farmers which was 97% of risk funds.
- Our volume goal for beginning farmers is \$103.6 million which is 100% of risk funds. At December 31, 2008, we had \$90.9 million in loans to beginning farmers which was 88% of risk funds.
- Our volume goal for small farmers is \$414.2 million which is 400% of risk funds. At December 31, 2008, we had \$197.4 million in loan volume to small farmers which was 191% of risk funds.

- Our goal for the number of loans is 1,637 of loans to young farmers, 1,530 of loans to beginning farmers and 6,938 of loans to small farmers. At December 31, 2008, we had 1,220 loans to young farmers, 1,072 loans to beginning farmers and 3,167 loans to small farmers.

We also have the opportunity to coordinate with the Bank of North Dakota and the Farm Service Agency in originating new loans. Our goal through coordinating with these two entities was to make 10 new loans to young farmers for \$500 thousand in loan volume, 10 new loans to beginning farmers for \$500 thousand in loan volume and 25 new loans to small farmers for \$1.25 million in loan volume. With this coordination effort in 2008, we made 8 loans to young farmers for \$2.3 million, 4 loans to beginning farmers for \$1.8 million and 6 loans to small farmers for \$0.2 million.

We also provide related services to this segment of our portfolio with a goal of continued growth equal to or greater than what our overall related services are growing. To date, the numbers of farmers served with certain services include:

| | Young | Beginning | Small |
|-----------------------|-------|-----------|-------|
| Hail insurance | 143 | 125 | 275 |
| Multi-peril insurance | 120 | 112 | 299 |
| Life insurance | 319 | 219 | 224 |

We also have a plan for marketing and outreach activities for this segment of our territory. We had goals of distributing 750 FFA Handbooks to 35 schools and actually gave 786 Handbooks to 35 schools. Our goal was to attend 6 FFA banquets and 5 were attended. We planned to attend 6 FFA Alumni Meetings and 9 were attended. We had a goal of attending 12 4-H premium sales with 13 attended. We have participated with the other Farm Credit System associations in North Dakota in granting 4 innovative grants for a total of \$2 thousand. We planned for and awarded four \$500 scholarships to sons and daughters of the agriculture community. We had planned presentations to 5 agriculture classes with 1 presentation completed. We had a goal of attending 10 Adult Farm Management events with 12 attended. We had a goal of attending 30 marketing club meetings with 14 attended. Our goal was to participate in 8 agriculture shows with 11 completed. We had a goal of 2 and completed 4 direct mailings to young, beginning and small farmers in our area. We had a goal of staff to attend 100 key community agriculture events in our territory and 255 were attended. We had a goal of facilitating 2 college funding seminars with 2 completed. We also achieved our goal to participate in 6 kid's farm safety events with 2 completed.

Our website has a page dedicated to our Young, Beginning and Small Farmers program along with information sent in our customer newsletter targeted at the Young, Beginning and Small Farmers segment of our territory.

Our specifically designed credit programs and services for young, beginning and small farmers include underwriting standards and use of guarantees or other credit enhancements to ensure the program is conducted in a manner that protects the safety and soundness of the association.

Additional Loan Information

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

Investment Securities

In addition to loans, we hold investment securities. Investments represent our share of investment notes in a trust of equipment loans. These were purchased through our participation in the Commercial Finance Group (CFG). Investments totaled \$7.7 million at December 31, 2008. For further information, see Note 3.

Results of Operations

The following table illustrates profitability information (in thousands):

| For the year ended December 31 | 2008 | 2007 | 2006 |
|-----------------------------------|----------|---------|---------|
| Net income | \$11,461 | \$6,992 | \$5,259 |
| Return on average assets | 2.2% | 1.5% | 1.2% |
| Return on average members' equity | 10.7% | 7.1% | 5.7% |

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):

| | 2008 vs. 2007 | 2007 vs. 2006 |
|--|------------------|------------------|
| Increase (decrease) in net income | | |
| Net interest income | \$1,362 | \$1,067 |
| Provision for loan losses | (357) | 209 |
| Patronage income | (105) | 113 |
| Financially related services and miscellaneous income, net | 4,318 | 925 |
| Operating expenses | (935) | (332) |
| Provision for income taxes | 186 | (249) |
| Total change in net income | \$4,469 | \$1,733 |

Net Interest Income

Net interest income was \$11.5 million for the year ended December 31, 2008. The following table quantifies changes in net interest income (in thousands):

| | 2008 vs. 2007 | 2007 vs. 2006 |
|--|------------------|------------------|
| Changes in net interest income due to: | | |
| Changes in volume | \$1,376 | \$690 |
| Changes in rates | (41) | 330 |
| Changes in nonaccrual income and other | 27 | 47 |
| Net change | \$1,362 | \$1,067 |

Net interest income included income on nonaccrual loans that totaled \$127 thousand in 2008, \$111 thousand in 2007, and \$69 thousand in 2006. 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 2.3% in 2008, 2.4% in 2007, and 2.3% in 2006.

Provision for Loan Losses

The variance in the provision for loan losses is related to our estimate of losses in our portfolio.

Patronage Income

We receive two different types of discretionary patronage from 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 investment in AgriBank.

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 2008, \$1.2 million in 2007, and \$1.0 million in 2006. Changes in our note payable to AgriBank along with a change in the patronage rate caused the variances in the patronage income amounts. The patronage rates paid by AgriBank were 27 basis points in 2008, 34 basis points in 2007, and 32 basis points in 2006.

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. The targeted rate equals the average cost of funds for all affiliated associations as a group. As of December 31, 2008, we no longer had any preferred stock investment in AgriBank. Equalization income totaled \$7 thousand for 2008, \$26 thousand for 2007, and \$67 thousand for 2006.

Beginning in 2007, we also received patronage from CoBank, ACB. This patronage income totaled \$3 thousand in both 2008 and in 2007.

Financially Related Services and Miscellaneous Income, Net

Financially related services and miscellaneous income, net is primarily comprised of insurance related income. The increase in financially related services and miscellaneous income, net is primarily due to an increase in multi-peril crop insurance income. The increase in multi-peril crop insurance income is primarily due to an increase in price election coverage's due to higher commodity prices.

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 | 2008 | 2007 | 2006 |
|--------------------------------|---------|---------|---------|
| Salaries and benefits | \$6,015 | \$5,386 | \$5,192 |
| Purchased and vendor services | 631 | 612 | 623 |
| Occupancy and equipment | 614 | 531 | 505 |
| Advertising and promotion | 408 | 365 | 321 |
| Examination | 188 | 187 | 186 |
| Farm Credit System insurance | 702 | 597 | 548 |
| Other | 1,290 | 1,235 | 1,206 |
| Total | \$9,848 | \$8,913 | \$8,581 |
| Operating rate | 2.0% | 2.1% | 2.2% |

The operating expense increases were primarily related to an increase in salary and benefit costs, occupancy and equipment, and Farm Credit System insurance expense.

Provision for Income Taxes

We recorded tax expense of \$146 thousand for the year ended December 31, 2008, compared to \$332 thousand for 2007, and \$83 thousand for 2006. The change in provision between 2008 and 2007 is related to a decrease in taxable income. The change in provision between 2007 and

2006 is related to increased taxable income for 2007 and reversal of a tax loss contingency during September 2006. 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 2008, our average balance was \$409.5 million with an average interest rate of 3.2%. Our average balance during 2007 was \$350.4 million with an average interest rate of 5.3% and during 2006 our average balance was \$324.7 million with an average interest rate of 5.1%. 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, 2008, we had \$77.0 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 plus lease programs 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 market interest rate risk.

Capital Adequacy

Total members' equity increased \$11.5 million during 2008 due to net income for the period and an increase in capital stock and participation certificates outstanding.

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

| As of December 31 | 2008 | 2007 | 2006 |
|--|-----------|-----------|----------|
| Members' equity | \$113,705 | \$102,180 | \$95,254 |
| Surplus as a percentage of members' equity | 98.2% | 98.0% | 97.8% |
| Permanent capital ratio | 16.8% | 18.8% | 18.7% |
| Total surplus ratio | 16.5% | 18.4% | 18.3% |
| Core surplus ratio | 16.5% | 18.4% | 18.2% |

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, 2008, 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, 2008, our optimum permanent capital target range was 20% to 22%.

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.

Initiatives

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

FCS Commercial Finance Group

We participate in the FCS Commercial Finance Group (CFG) alliance with other associations in Minnesota and North Dakota to meet the financial needs of agricultural producers and agribusiness operations. The CFG is governed by representatives from each participating association. The income, expense and loss sharing arrangements are based on each association's participation interest of the CFG volume. Each association determines its commitment for new volume opportunities based on its capacity and preferences. We had \$114.2 million of CFG volume at December 31, 2008, \$59.9 million at December 31, 2007, and \$43.9 million at December 31, 2006. We also had \$68.8 million of available commitment on CFG loans at December 31, 2008.

ProPartners Financial

We participate in ProPartners Financial with other associations in North Dakota, Minnesota, Illinois, Wisconsin, and Michigan. ProPartners Financial provides financing programs for clients of agribusiness companies. ProPartners Financial is directed by representatives from the participating associations. The income, expense and loss sharing arrangements are based on each association's participation interest of ProPartners Financial volume. Each association's allocation is established according to a prescribed formula based on risk funds of the associations. We had \$20.7 million of ProPartners Financial volume at December 31, 2008, \$16.2 million at December 31, 2007, and \$12.1 million at December 31, 2006.

Trade Credit

We have entered into agreements with certain dealer networks to provide alternative service delivery channels to borrowers. These trade credit opportunities create more flexible and accessible financing options to borrowers through programs such as dealer point-of-purchase financing.

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.

Mission Related Investments

We are participating in an investment 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 \$120 thousand of volume under this pilot program outstanding at December 31, 2008 and \$141 thousand of volume outstanding at December 31, 2007. We had not entered into any such transactions prior to 2007.

In addition to the pilot program, beginning in 2008, we purchased shares of investment notes in a trust of equipment loans. These investments totaled \$7.7 million at December 31, 2008.

Relationship with AgriBank

Borrowings

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act of 1971, as amended. 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 cost of servicing component,
- a bank spread component, and
- a risk premium component, if applicable.

In the periods presented, we were not subject to the risk premium component. 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, 2008, we were required to maintain a common stock investment equal to 2.5% of the average quarterly balance of our note payable to AgriBank. AgriBank's current bylaws allow AgriBank to increase the required investment to 4.0%. Effective in 2009, our required investment will include an additional 1% on growth that exceeds a targeted rate. At December 31, 2008, \$9.1 million of our investment in AgriBank consisted of stock representing distributed AgriBank surplus and \$2.5 million consisted of purchased investment. For the periods presented in this report, we have received no dividend income on this stock investment and we do not anticipate any in future years.

Patronage

We receive patronage income 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 patronage rates. As of December 31, 2008, we no longer had any preferred stock in AgriBank.

Purchased Services

We purchase various services from AgriBank including:

- certain information systems,
- certain financial services,
- certain accounting and reporting services, and
- selected retail product processing and support.

The total cost of services we purchased from AgriBank was \$484 thousand in 2008, \$460 thousand in 2007, and \$553 thousand in 2006.

Affect on Members' Investment

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 Post Office Box 70, Minot, North Dakota 58702-0070, (701) 852-1265 or via electronic mail to info@farmcreditnd.com or through our website at www.farmcreditnd.com. You may also contact AgriBank at 375 Jackson

Street, St. Paul, MN 55101-1810, (651) 282-8800, or via electronic mail to AGRIBANKMN@agribank.com. The reports are also available through AgriBank's website at www.agribank.com.

To request a free copy of our 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 40 days after the end of each calendar quarter.

Relationship with Other Farm Credit Institutions

We have a relationship with CoBank, ACB which involves purchasing or selling participation interests in loans. As part of this relationship, we have a \$3 thousand equity investment in CoBank, ACB. CoBank, ACB provides direct loan funds to associations in its chartered territory and also makes loans to cooperatives and other eligible borrowers.

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.

REPORT OF MANAGEMENT

Farm Credit Services of North Dakota, ACA



We prepare the consolidated financial statements of Farm Credit Services of North Dakota, ACA 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 Farm Credit Services of North Dakota, 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 Farm Credit Services of North Dakota, ACA.

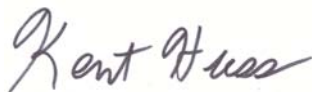
The undersigned certify we have reviewed Farm Credit Services of North Dakota, ACA's annual report and it has been prepared in accordance with all applicable statutory or regulatory requirements and the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Rollin Tonneson
Chairperson of the Board
Farm Credit Services of North Dakota, ACA



Claude Sem
President and Chief Executive Officer
Farm Credit Services of North Dakota, ACA



Kent Huss
Chief Financial Officer
Farm Credit Services of North Dakota, ACA

February 27, 2009

REPORT OF AUDIT COMMITTEE

Farm Credit Services of North Dakota, ACA



The consolidated financial statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of a subset of the Board of Directors of Farm Credit Services of North Dakota, ACA. 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, 2008, 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, 2008.



Bill Ongstad
Chairperson of the Audit Committee
Farm Credit Services of North Dakota, ACA

Members of the Audit Committee are:

Bill Ongstad
Bryan Ankenbauer
Phil Lowe
Rollin Tonneson

February 27, 2009

PricewaterhouseCoopers LLP
225 South Sixth Street
Suite 1400
Minneapolis MN 55402
Telephone (612) 596 6000
www.pwc.com

Report of Independent Auditors

To the Board of Directors and Members of
Farm Credit Services of North Dakota, 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 Farm Credit Services of North Dakota, ACA (the Association) and its subsidiaries at December 31, 2008, 2007 and 2006, 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

February 27, 2009

CONSOLIDATED STATEMENT OF CONDITION

Farm Credit Services of North Dakota, ACA

(Dollars in thousands)

| As of December 31 | 2008 | 2007 | 2006 |
|--|-----------|-----------|-----------|
| ASSETS | | | |
| Loans | \$554,556 | \$447,792 | \$410,913 |
| Allowance for loan losses | 1,433 | 1,216 | 1,277 |
| Net loans | 553,123 | 446,576 | 409,636 |
| Investment in AgriBank, FCB | 11,570 | 9,194 | 9,109 |
| Investment securities | 7,674 | -- | -- |
| Accrued interest receivable | 9,784 | 11,491 | 12,567 |
| Premises and equipment, net | 1,990 | 1,562 | 1,715 |
| Other property owned | 246 | -- | -- |
| Assets held for lease, net | 2,104 | 1,775 | 1,844 |
| Other assets | 2,802 | 2,328 | 2,925 |
| Total assets | \$589,293 | \$472,926 | \$437,796 |
| LIABILITIES | | | |
| Note payable to AgriBank, FCB | \$469,319 | \$363,361 | \$334,967 |
| Accrued interest payable | 3,275 | 4,649 | 4,716 |
| Net deferred income tax liability | 842 | 681 | 829 |
| Other liabilities | 2,152 | 2,055 | 2,030 |
| Total liabilities | 475,588 | 370,746 | 342,542 |
| MEMBERS' EQUITY | | | |
| Protected members' equity | 4 | 11 | 12 |
| Capital stock and participation certificates | 2,073 | 2,002 | 2,067 |
| Unallocated surplus | 111,628 | 100,167 | 93,175 |
| Total members' equity | 113,705 | 102,180 | 95,254 |
| Total liabilities and members' equity | \$589,293 | \$472,926 | \$437,796 |

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

CONSOLIDATED STATEMENT OF INCOME

Farm Credit Services of North Dakota, ACA

(Dollars in thousands)

| Year ended December 31 | 2008 | 2007 | 2006 |
|--|-----------------|----------|----------|
| Interest income | \$24,572 | \$28,658 | \$25,741 |
| Interest expense | 13,102 | 18,550 | 16,700 |
| Net interest income | 11,470 | 10,108 | 9,041 |
| Provision for (reversal of) loan losses | 290 | (67) | 142 |
| Net interest income after provision for loan losses | 11,180 | 10,175 | 8,899 |
| Other income | | | |
| Patronage income | 1,115 | 1,220 | 1,107 |
| Financially related services and miscellaneous income, net | 9,160 | 4,842 | 3,917 |
| Total other income | 10,275 | 6,062 | 5,024 |
| Operating expense | | | |
| Salaries and employee benefits | 6,015 | 5,386 | 5,192 |
| Other operating expense | 3,833 | 3,527 | 3,389 |
| Total operating expense | 9,848 | 8,913 | 8,581 |
| Income before income taxes | 11,607 | 7,324 | 5,342 |
| Provision for income taxes | 146 | 332 | 83 |
| Net income | \$11,461 | \$6,992 | \$5,259 |

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

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

Farm Credit Services of North Dakota, ACA

(Dollars in thousands)

| | Protected Members' Equity | Capital Stock and Participation Certificates | Unallocated Surplus | Total Members' Equity |
|--|---------------------------------|---|------------------------|-----------------------------|
| Balance at December 31, 2005 | \$20 | \$2,089 | \$87,916 | \$90,025 |
| Net income | | | 5,259 | 5,259 |
| Capital stock/participation certificates issued | | 295 | | 295 |
| Capital stock/participation certificates retired | (8) | (317) | | (325) |
| Balance at December 31, 2006 | 12 | 2,067 | 93,175 | 95,254 |
| Net income | | | 6,992 | 6,992 |
| Capital stock/participation certificates issued | | 307 | | 307 |
| Capital stock/participation certificates retired | (1) | (372) | | (373) |
| Balance at December 31, 2007 | 11 | 2,002 | 100,167 | 102,180 |
| Net income | | | 11,461 | 11,461 |
| Capital stock/participation certificates issued | | 429 | | 429 |
| Capital stock/participation certificates retired | (7) | (358) | | (365) |
| Balance at December 31, 2008 | \$4 | \$2,073 | \$111,628 | \$113,705 |

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

CONSOLIDATED STATEMENT OF CASH FLOWS

Farm Credit Services of North Dakota, ACA

(Dollars in thousands)

| Year ended December 31 | 2008 | 2007 | 2006 |
|--|-----------|----------|----------|
| Cash flows from operating activities | | | |
| Net income | \$11,461 | \$6,992 | \$5,259 |
| Adjustments to reconcile net income to cash flows from operating activities: | | | |
| Depreciation on premises and equipment | 195 | 196 | 175 |
| Depreciation on assets held for lease | 432 | 377 | 440 |
| Provision for (reversal of) loan losses | 290 | (67) | 142 |
| Decrease (increase) in accrued interest receivable | 1,509 | 578 | (2,852) |
| (Increase) decrease in other assets | (474) | 597 | 4 |
| (Decrease) increase in accrued interest payable | (1,374) | (67) | 1,331 |
| Increase (decrease) in other liabilities | 258 | (123) | 151 |
| Gain on sale of other property owned | -- | -- | (15) |
| Gain on disposal of assets held for lease | (10) | (4) | (8) |
| Total adjustments | 826 | 1,487 | (632) |
| Net cash provided by operating activities | 12,287 | 8,479 | 4,627 |
| Cash flows from investing activities | | | |
| Increase in loans, net | (106,673) | (36,308) | (30,608) |
| Purchases of investment in AgriBank, FCB, net | (2,376) | (85) | -- |
| Increase in investment securities, net | (7,674) | -- | -- |
| Purchases of premises and equipment, net | (623) | (43) | (246) |
| Sales of other property owned, net | -- | -- | 42 |
| Purchases of assets held for lease, net | (751) | (304) | (235) |
| Net cash used in investing activities | (118,097) | (36,740) | (31,047) |
| Cash flows from financing activities | | | |
| Increase in note payable to AgriBank, FCB, net | 105,958 | 28,394 | 26,531 |
| Capital stock and participation certificates retired, net | (148) | (133) | (111) |
| Net cash provided by financing activities | 105,810 | 28,261 | 26,420 |
| Net change in cash | -- | -- | -- |
| Cash at beginning of year | -- | -- | -- |
| Cash at end of year | \$ -- | \$ -- | \$ -- |
| Supplemental schedule of non-cash activities | | | |
| Stock financed by loan activities | \$428 | \$306 | \$294 |
| Stock applied against loan principal | 216 | 239 | 213 |
| Interest transferred to loans | 198 | 498 | 242 |
| Loans transferred to other property owned | 246 | -- | -- |
| Supplemental information | | | |
| Interest paid | \$14,476 | \$18,617 | \$15,369 |
| Taxes paid | 203 | 528 | 389 |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Farm Credit Services of North Dakota, 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, 2008, the Farm Credit System consisted of four Farm Credit Banks, one Agricultural Credit Bank, and ninety associations. AgriBank and its affiliated associations are collectively referred to as the District. At December 31, 2008, 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 is authorized by Congress to regulate the Farm Credit System banks and associations. We are examined by the Farm Credit Administration and certain association actions are subject to the prior approval of the Farm Credit Administration and/or AgriBank.

Farm Credit Insurance Fund: The Farm Credit Act of 1971, as amended, established the Farm Credit System Insurance Corporation to administer the Farm Credit Insurance Fund. The Farm Credit 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 Farm Credit System Insurance Corporation, the Farm Credit Insurance Fund is also available to provide assistance to certain troubled Farm Credit System institutions and for the operating expenses of the Farm Credit System Insurance Corporation. Each Farm Credit System bank has been required to pay premiums into the Farm Credit Insurance Fund until the assets in the Farm Credit Insurance Fund equal 2% of Systemwide debt obligations. This percentage of aggregate obligations can be changed as the Farm Credit System Insurance Corporation, in its sole discretion, determines to be actuarially sound. Prior to July 1, 2008, the premiums were based on each bank's annual average loan principal outstanding. Insurance rates were 15 basis points on accrual loans and 25 basis points on nonaccrual loans through June 30, 2008. Effective July 1, 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. The premium rate on this base, originally 15 basis points, increased to 18 basis points effective October 1, 2008. AgriBank, in turn, assesses the associations premiums each year based on these same factors. Previously, AgriBank assessed the associations annual premiums based on the average principal outstanding of accrual and nonaccrual loans of the associations.

Association

Farm Credit Services of North Dakota, ACA and its subsidiaries, Farm Credit Services of North Dakota, FLCA and Farm Credit Services of North Dakota, 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 Benson, Bottineau, Burke, Divide, Eddy, Foster, McHenry, McKenzie, northern McLean, Mountrail, Pierce, Renville, Rolette, northern Sheridan, Ward, Wells and Williams in the state of North Dakota.

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 and provides lease financing options for agricultural production or operating purposes. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. 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 fee appraisals and through affiliations, farm records, income tax planning and preparation services, and retirement and succession planning services to our members.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America and the prevailing practices within the financial services industry. Preparing financial statements in conformity with accounting principles generally accepted in the United States of America 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.

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

The following are our 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. We currently account for loan origination fees in accordance with Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating*

or *Acquiring Loans and Initial Direct Costs of Leases*, which establishes the accounting for nonrefundable fees and costs associated with lending, commitment to lend, or purchasing a loan or group of loans. Material fees, net of related costs, are deferred and recognized over the life of the loan as an adjustment to the yield. Other 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.

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
- current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually under Statement of Financial Accounting Standard No. 114, *Accounting by Creditors for Impairment of a Loan*, 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 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 collection is unlikely, 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.

We apply Statement of Financial Accounting Standard No. 5, *Accounting for Contingencies*, to loans that are not individually assessed as impaired. An allowance is recorded for probable and estimable credit losses as of the financial statement date.

Changes in the allowance for loan losses consist of provision activity, recorded as "Provision for (reversal of) 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.

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 the lower of the carrying amount or the 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.

Leases: We have finance and operating leases. Under finance leases, unearned income from lease contracts represents the excess of gross lease receivables plus residual receivables over the cost of leased equipment. We amortize net unearned finance income to earnings on the interest method. The carrying amount of finance leases is included in "Loans" on the Consolidated Statement of Condition and represents lease rent receivables net of the unearned income plus the residual receivable. We recognize operating lease revenue evenly over the term of the lease. We charge depreciation and other expenses against revenue as incurred. The carrying amount of operating leases is included in "Assets held for lease, net" on the Consolidated Statement of Condition and represents the asset cost net of accumulated depreciation.

Employee Benefit Plans: Our employees may be eligible to 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. Employees hired after December 31, 2006, only participate in the defined contribution plan.

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.

We also provide certain health and life insurance benefits to eligible retired employees according to the terms of those benefit plans. 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. We have 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 of 1971, as amended.

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

Fair Value Measurement: Effective January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It also clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. It describes three levels of output that may be used to measure fair value.

Where quoted prices are available in an active market, investment securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. The fair value disclosures have been expanded in accordance with SFAS No. 157 as described in Note 13.

NOTE 3: LOANS AND INVESTMENT SECURITIES

Loans consisted of the following (in thousands):

| As of December 31, 2008 | Amount | Percentage |
|---------------------------------|-----------|------------|
| Long-term agricultural mortgage | \$214,811 | 38.5% |
| Production | 102,253 | 18.3% |
| Intermediate term | 98,657 | 17.7% |
| Farm-related business | 1,134 | 0.2% |
| Processing and marketing | 8 | -- |
| Finance leases | 1,126 | 0.2% |
| Participations purchased | 139,232 | 25.0% |
| Other | 285 | 0.1% |
| Subtotal | 557,506 | 100.0% |
| Participations sold | (2,950) | |
| Total loans | \$554,556 | |

| As of December 31, 2007 | Amount | Percentage |
|---------------------------------|-----------|------------|
| Long-term agricultural mortgage | \$197,281 | 44.0% |
| Production | 82,795 | 18.5% |
| Intermediate term | 83,187 | 18.5% |
| Farm-related business | 519 | 0.1% |
| Processing and marketing | 125 | -- |
| Finance leases | 1,337 | 0.3% |
| Participations purchased | 83,019 | 18.5% |
| Other | 566 | 0.1% |
| Subtotal | 448,829 | 100.0% |
| Participations sold | (1,037) | |
| Total loans | \$447,792 | |

| As of December 31, 2006 | Amount | Percentage |
|---------------------------------|-----------|------------|
| Long-term agricultural mortgage | \$190,598 | 45.9% |
| Production | 86,367 | 20.8% |
| Intermediate term | 75,361 | 18.1% |
| Farm-related business | 486 | 0.1% |
| Processing and marketing | 233 | 0.1% |
| Finance leases | 1,714 | 0.4% |
| Participations purchased | 60,311 | 14.5% |
| Other | 546 | 0.1% |
| Subtotal | 415,616 | 100.0% |
| Participations sold | (4,703) | |
| Total loans | \$410,913 | |

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, 2008 | Participations | |
|--|----------------|---------|
| | Purchased | Sold |
| Participations purchased from/sold to: | | |
| Other Farm Credit System institutions | \$138,201 | \$1,370 |
| AgriBank, FCB | -- | 525 |
| Non-Farm Credit System institutions | 1,031 | 1,055 |
| Total participations purchased/sold | \$139,232 | \$2,950 |

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

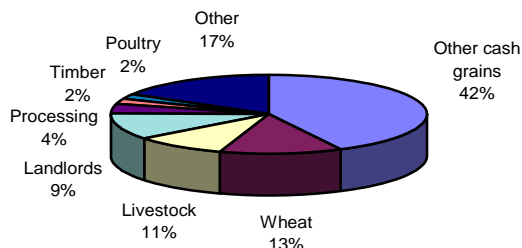
Portfolio Concentrations

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

At December 31, 2008, volume plus commitments to our ten largest borrowers totaled an amount equal to 31.2% of members' equity.

Our agricultural commodity concentrations at December 31, 2008, were as follows:

Concentrations of Agricultural Commodities



The commodity concentrations have not changed materially from prior years.

We are chartered to operate in certain counties in North Dakota. Approximately 37.3% of our total loan portfolio was in the counties of McHenry, McLean, Mountrail, Ward, and Wells.

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 (accruing volume includes accrued interest receivable) information (in thousands):

| As of December 31 | 2008 | 2007 | 2006 |
|---|---------|---------|---------|
| Nonaccrual loans: | | | |
| Current as to principal and interest | \$3,990 | \$1,137 | \$2,141 |
| Past due | 743 | 552 | 783 |
| Total nonaccrual loans | 4,733 | 1,689 | 2,924 |
| Accruing restructured loans | 932 | 986 | 520 |
| Loans past due 90 days or more still accruing | 492 | 64 | -- |
| Total risk loans | \$6,157 | \$2,739 | \$3,444 |
| Volume with specific reserves | \$2,742 | \$618 | \$295 |
| Volume without specific reserves | 3,415 | 2,121 | 3,149 |
| Total risk loans | \$6,157 | \$2,739 | \$3,444 |
| Total specific reserves | \$449 | \$245 | \$228 |
| Year ended December 31 | 2008 | 2007 | 2006 |
| Income on accrual risk loans | \$60 | \$62 | \$46 |
| Income on nonaccrual loans | 127 | 111 | 69 |
| Total income on risk loans | \$187 | \$173 | \$115 |
| Average recorded investment | \$3,398 | \$3,030 | \$2,907 |

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at December 31, 2008.

Loans 90 days or more past due and still accruing interest were adequately secured and in the process of collection.

The increase in nonaccrual loans is primarily from the transfer of two accounts involved in the ethanol and protein markets to nonaccrual status in December 2008.

Investment Securities

Beginning in 2008, we purchased shares of investment notes in a trust of equipment loans. Investments totaled \$7.7 million at December 31, 2008. The following table presents the book value, unrealized gain/loss and fair value of the investment securities (in thousands).

| As of December 31 | 2008 | 2007 | 2006 |
|-------------------------|---------|-------|-------|
| Book value | \$7,674 | \$ -- | \$ -- |
| Gross unrealized gains | 86 | -- | -- |
| Gross unrealized losses | (907) | -- | -- |
| Estimated fair value | \$6,853 | \$ -- | \$ -- |
| Weighted Average Yield | 4.2% | -- | -- |

Income is recorded in interest income and totaled \$239 thousand in 2008.

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 | 2008 | 2007 | 2006 |
|---|---------|---------|---------|
| Balance at beginning of year | \$1,216 | \$1,277 | \$1,175 |
| Provision for (reversal of) loan losses | 290 | (67) | 142 |
| Loan recoveries | 17 | 47 | 43 |
| Loan chargeoffs | (90) | (41) | (83) |
| Balance at end of year | \$1,433 | \$1,216 | \$1,277 |

NOTE 5: INVESTMENT IN AGRIBANK

At December 31, 2008, we were required by AgriBank to maintain an investment equal to 2.5% of the quarter-end balance of our note payable to AgriBank. This remained unchanged from the requirement at December 31, 2007 and December 31, 2006. Effective in 2009, our required investment will include an additional 1% on growth that exceeds a targeted rate.

The following summarizes investment balances (in thousands):

| | 2008 | 2007 | 2006 |
|--------------------|----------|---------|---------|
| As of December 31: | | | |
| Common stock | \$11,570 | \$9,194 | \$8,738 |
| Preferred stock | -- | -- | 371 |
| Total investment | \$11,570 | \$9,194 | \$9,109 |

NOTE 6: PREMISES AND EQUIPMENT

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

| As of December 31 | 2008 | 2007 | 2006 |
|----------------------------------|---------|---------|---------|
| Land, buildings and improvements | \$3,837 | \$3,249 | \$3,249 |
| Furniture and equipment | 567 | 547 | 516 |
| Subtotal | 4,404 | 3,796 | 3,765 |
| Less: accumulated depreciation | (2,414) | (2,234) | (2,050) |
| Total | \$1,990 | \$1,562 | \$1,715 |

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 \$550 million and the outstanding principal under the line of credit was \$469.3 million as of December 31, 2008. The interest rate is adjusted monthly and was 2.2% at December 31, 2008. During 2008, our average balance was \$409.5 million with an average interest rate of 3.2%. Our average balance during 2007 was \$350.4 million with an average interest rate of 5.3% and during 2006 our average balance was \$324.7 million with an average interest rate of 5.1%. Our note payable's maturity date is September 30, 2009, 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. We cannot exceed these limitations without approval from AgriBank. At December 31, 2008, 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 of 1971, as amended, each borrower is required to invest in us as a condition of obtaining a loan. As authorized by the Agricultural Credit Act of 1987 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 each customer to whom a lease is issued if not already a stockholder. Also, the purchase of one participation certificate is required of each customer who purchases financial services if not already a stockholder. 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/lease is made, but usually does not make a cash investment. 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 of 1971, as amended, 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 below:

- The permanent capital ratio is average at-risk capital divided by average risk-adjusted assets. At December 31, 2008, our ratio was 16.8%.
- 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, 2008, our ratio was 16.5%.
- 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, 2008, our ratio was 16.5%.

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, 2008 and December 31, 2007, we no longer had any preferred stock. At December 31, 2006, we included 4.1% of our investment in AgriBank in 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, 2008. All shares and participation certificates were \$5.00 par value.

| As of December 31, 2008 | Shares Outstanding |
|--|--------------------|
| Class A common stock (protected) | 748 |
| Class B common stock (at-risk) | 413,397 |
| Class E participation certificates (at-risk) | 1,279 |

Under our bylaws, we are also authorized to issue Class C and Class D common 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 B 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, 2008, 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 Class A common stock, and
- second, pro rata to holders of Class B, C and D common stock and Class E participation certificates.

In the event of impairment, losses will be absorbed first by holders of Class D common stock, then by concurrent impairment of Class A, B and C common stock and Class E participation certificates; however, protected stock will be retired at par value regardless of impairment.

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

Patronage Distributions

The Farm Credit Administration Regulations prohibits 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 2009. However, we do not have a patronage program to make such distributions.

NOTE 9: INCOME TAXES

Provision for Income Taxes

Our provision for income taxes follows (in thousands):

| For the year ended December 31 | 2008 | 2007 | 2006 |
|--------------------------------|--------|-------|-------|
| Current: | | | |
| Federal | (\$19) | \$422 | \$142 |
| State | 4 | 58 | 43 |
| Total current | (15) | 480 | 185 |
| Deferred: | | | |
| Federal | 143 | (131) | (87) |
| State | 18 | (17) | (15) |
| Total deferred | 161 | (148) | (102) |
| Provision for income taxes | \$146 | \$332 | \$83 |
| Effective tax rate | 1.3% | 4.5% | 1.6% |

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 | 2008 | 2007 | 2006 |
|--------------------------------|---------|---------|---------|
| Federal tax at statutory rate | \$3,946 | \$2,490 | \$1,816 |
| State tax, net | 11 | 27 | 16 |
| Effect of non-taxable entity | (3,824) | (2,192) | (1,640) |
| Loss contingency reversal | -- | -- | (119) |
| Other | 13 | 7 | 10 |
| Provision for income taxes | \$146 | \$332 | \$83 |

Tax Related Matters

In 2002, we established loss contingencies in the form of tax reserves related to certain income accrued by Farm Credit Services of North Dakota, FLCA in connection with settlements with the IRS and the State of North Dakota. Due to the passing of statutes of limitations on assessing taxes, those contingencies have now expired and have been reversed. The

reversals, in the amount of \$119 thousand in September 2006, are included in the provision for income taxes in the Consolidated Statement of Income.

Deferred Income Taxes

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

| As of December 31 | 2008 | 2007 | 2006 |
|---------------------------------------|-----------|---------|-----------|
| Allowance for loan losses | \$160 | \$207 | \$222 |
| Postretirement benefits accrual | 60 | 56 | 52 |
| Leasing related | (544) | (426) | (537) |
| Accrued patronage income not received | (46) | (81) | (79) |
| AgriBank, FCB 2002 allocated stock | (263) | (263) | (263) |
| Accrued pension asset | (167) | (153) | (193) |
| Depreciation | (77) | (66) | (78) |
| Other assets | 35 | 45 | 47 |
| Net deferred tax liabilities | (\$842) | (\$681) | (\$829) |
| Gross deferred tax assets | \$255 | \$308 | \$321 |
| Gross deferred tax liabilities | (\$1,097) | (\$989) | (\$1,150) |

A valuation reserve for the deferred tax assets was not necessary at December 31, 2008, December 31, 2007, or December 31, 2006.

We have not provided deferred income taxes on approximately \$7.5 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. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of \$63.0 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, 2008. At the time of adoption, as well as at December 31, 2008, we had no uncertain income tax positions to recognize.

NOTE 10: EMPLOYEE BENEFIT PLANS

Our employees may be eligible to 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 \$384 thousand for 2008 and \$122 thousand for 2007. We did not make a contribution in 2006. Plan expenses included in salaries and employee benefits expense in the Consolidated Statement of Income were \$303 thousand for 2008, \$356 thousand for 2007, and \$345 thousand for 2006. Additional financial information for the Plan may be found in the AgriBank, FCB and Affiliated Associations 2008 Annual Report.

The funded status of the plans will be recorded at the District level only. Please refer to the AgriBank, FCB and Affiliated Associations 2008 Annual Report for detailed disclosures under Statement of Financial

Accounting Standard No. 158 – *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*

In December 2007, the District adopted SFAS No. 158, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of fiscal year end in 2008. The Standard allows for the use of the measurements determined for the prior year-end.

Under this approach, pension and postretirement benefit income measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) was credited to beginning 2008 unallocated surplus. As a result, the District decreased unallocated surplus by \$5.0 million and increased the pension and other postretirement benefits liabilities by \$5.0 million.

Life Insurance and Retiree Medical Plans

District employers also provide certain health and life insurance benefits to eligible retired employees according to the terms of those benefit plans. 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 \$33 thousand for 2008, \$34 thousand for 2007, and \$4 thousand for 2006. Additional financial information for this plan may be found in the AgriBank, FCB and Affiliated Associations 2008 Annual Report.

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 and recorded expense to this plan were \$193 thousand in 2008, \$159 thousand in 2007, and \$146 thousand in 2006.

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, 2008, involved more than a normal risk of collectibility.

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

| | 2008 | 2007 | 2006 |
|--|-----------------|---------|---------|
| As of December 31: | | | |
| Total related party loans and leases | \$8,038 | \$5,947 | \$5,861 |
| For the year ended December 31: | | | |
| Advances to related parties | \$11,301 | \$5,615 | \$5,032 |
| Repayments by related parties | 9,216 | 5,738 | 4,227 |

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, and selected retail product processing and support services. The total cost of services we purchased from AgriBank was \$484 thousand in 2008, \$460 thousand in 2007, and \$553 thousand in 2006.

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 and letters of 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. Standby letters of credit are agreements to pay a beneficiary if there is a default on a contractual arrangement. At December 31, 2008, we had commitments to extend credit and unexercised commitments related to standby letters of credit of \$183.2 million. Additionally, we had \$6.4 million of issued standby letters of credit as of December 31, 2008.

Commitments to extend credit and letters of credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments and letters of credit remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit and letters of credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Certain letters of credit may have recourse provisions that would enable us to recover from third parties amounts paid under guarantees, thereby limiting our maximum potential exposure. The credit risk involved in issuing these financial instruments is essentially the same as that involved in extending loans to borrowers and we apply the same credit policies.

NOTE 13: 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.

These estimates involve uncertainties and matters of judgment and cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Estimating the fair value of our investment in AgriBank is not practical because the stock is not traded. As discussed in Note 2 and Note 5, the investment is a requirement of borrowing from AgriBank.

A description of the methods and assumptions used to estimate the fair value of each class of our financial instruments, for which it is practical to estimate that value, follows:

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.

SFAS No. 157 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 2 for additional information.

Assets measured at fair value on a non-recurring basis at December 31, 2008 for each of the fair value hierarchy levels are summarized below.

| | Fair Value Measurement Using | | | Total Fair Value | Total Gains (Losses) |
|--------|------------------------------|---------|---------|------------------|----------------------|
| | Level 1 | Level 2 | Level 3 | | |
| Loans* | \$0 | \$20 | \$2,273 | \$2,293 | (\$449) |

* Represents the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value was based upon the underlying real estate collateral. The fair value measurement process uses independent appraisals and other market-based information. As a result, these fair value measurements fall within Level 2 of the hierarchy. However, 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.

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 and letters of credit: Estimating the fair value of commitments and letters of credit is determined by the inherent credit loss in such instruments.

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

| | Carrying Amount | Estimated Fair Value |
|--|-----------------|----------------------|
| As of December 31, 2008 | | |
| Financial assets: | | |
| Loans, net | \$553,123 | \$562,078 |
| Investment securities | 7,674 | 6,853 |
| Financial liabilities: | | |
| Note payable to AgriBank, FCB | \$469,319 | \$477,195 |
| Unrecognized financial instruments: | | |
| Commitments to extend credit and letters of credit | | (\$237) |
| As of December 31, 2007 | | |
| Financial assets: | | |
| Loans, net | \$446,576 | \$449,370 |
| Financial liabilities: | | |
| Note payable to AgriBank, FCB | \$363,361 | \$364,892 |
| Unrecognized financial instruments: | | |
| Commitments to extend credit and letters of credit | | (\$190) |
| As of December 31, 2006 | | |
| Financial assets: | | |
| Loans, net | \$409,636 | \$409,140 |
| Financial liabilities: | | |
| Note payable to AgriBank, FCB | \$334,967 | \$334,683 |
| Unrecognized financial instruments: | | |
| Commitments to extend credit and letters of credit | | (\$155) |

NOTE 14: QUARTERLY FINANCIAL INFORMATION (Unaudited)

Quarterly consolidated results of operations for the years ended December 31, 2008, December 31, 2007 and December 31, 2006, follow (in thousands):

| 2008 | First | Second | Third | Fourth | Total |
|-----------------------------|--------------|---------------|--------------|---------------|--------------|
| Net interest income | \$2,787 | \$2,711 | \$3,006 | \$2,966 | \$11,470 |
| (Reversal of) provision for | | | | | |
| loan losses | (142) | 40 | 25 | 367 | 290 |
| Patronage income | 230 | 267 | 304 | 314 | 1,115 |
| Other expense, net | 1,349 | 903 | (1,950) | 386 | 688 |
| Provision for (reversal of) | | | | | |
| income taxes | 54 | (10) | 56 | 46 | 146 |
| Net income | \$1,756 | \$2,045 | \$5,179 | \$2,481 | \$11,461 |
| 2007 | First | Second | Third | Fourth | Total |
| Net interest income | \$2,443 | \$2,544 | \$2,600 | \$2,521 | \$10,108 |
| (Reversal of) provision for | | | | | |
| loan losses | (96) | (32) | 56 | 5 | (67) |
| Patronage income | 224 | 242 | 260 | 494 | 1,220 |
| Other expense, net | 1,207 | 1,055 | 541 | 1,268 | 4,071 |
| Provision for income taxes | 91 | 84 | 59 | 98 | 332 |
| Net income | \$1,465 | \$1,679 | \$2,204 | \$1,644 | \$6,992 |
| 2006 | First | Second | Third | Fourth | Total |
| Net interest income | \$2,166 | \$2,195 | \$2,323 | \$2,357 | \$9,041 |
| (Reversal of) provision for | | | | | |
| loan losses | (47) | 316 | (192) | 65 | 142 |
| Patronage income | 196 | 221 | 241 | 449 | 1,107 |
| Other expense, net | 1,421 | 1,021 | 819 | 1,403 | 4,664 |
| Provision for (reversal of) | | | | | |
| income taxes | 48 | (3) | (26) | 64 | 83 |
| Net income | \$940 | \$1,082 | \$1,963 | \$1,274 | \$5,259 |

DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

Farm Credit Services of North Dakota, 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 |
|------------|-------------|--------------------------------------|
| Minot | Owned | Headquarters/Branch |
| Minot | Owned | Commercial Lot |
| Carrington | Owned | Branch |
| Williston | Owned | Branch |
| Bottineau | Owned | Branch |
| Rugby | Owned | Branch |
| Minot | Owned | Ward County Crop Insurance Office |
| Rugby | Leased | Schaan Crop Insurance Office |
| Bowbells | Leased | Bowbells Crop Insurance Office |

LEGAL PROCEEDINGS

Information regarding legal proceedings is discussed in Note 9 and Note 12 of this annual report. We were not subject to any enforcement actions at December 31, 2008.

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, 2008, 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:

Rollin Tonneson, Chairperson of the Board, Souris, is a self-employed grain farmer. Mr. Tonneson also serves on the Grace Lutheran Church Elder Board. His term on the Association Board expires in 2011.

Bill Ongstad, First Vice Chairperson of the Board, Harvey, is a self-employed grain farmer and producer of North Dakota certified wheat seed and certified pinto bean seed. Mr. Ongstad was a 12 year member of the Harvey School Board. He is currently on the Wells County Mentoring Advisory Board and is a director for the Garrison Diversion Conservancy District. He is a past president of the U.S. Durum Growers Association. He also serves as the Vice Chairperson for Precision Ag Results, a precision farming consulting business. His term on the Association Board expires in 2009.

Bryan Ankenbauer, Second Vice Chairperson of the Board, Bowbells, is a self-employed grain farmer. Mr. Ankenbauer is also a director for the U.S. Durum Growers Association. Bryan and his wife Joy are the AWANA commanders for their local church. His term on the board expires in 2011.

Tim Dwyer, Sidney, is a self-employed grain and livestock farmer along with his wife Tori and four daughters. He served on the local school board for several years and previously served on the church trustee board and is a past county representative of the North Dakota Wheat Commission. His term on the Association Board expires in 2009.

Arlen Gilbertson, Parshall, is a self-employed grain and livestock farmer and operates a farm and ranch bed and breakfast establishment with his wife, Ronna and son, Elmer. His term on the Association Board expires in 2011.

Daryl Klein, Balta, is a self-employed grain farmer. Mr. Klein is also a director for the Farmers Union Oil Cooperative, Balta, which is involved in selling petroleum products. His term on the Association Board expires in 2010.

Jim Limke, Lansford, is a self-employed grain farmer. Mr. Limke also serves on the Lockwood Township Board, Renville County Township Officers Association Board, and St. John's Catholic Church Board. His term on the Association Board expires in 2010.

Phil Lowe, Outside Director, Minot, is the general manager of Lowe's Garden Center & Floral. Mr. Lowe is also a director for Trinity Hospital. His term on the Association Board expires in 2009.

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 receives \$300 per diem for each meeting in attendance. In addition, the board chairperson receives a \$2,000 annual retainer fee and the other board members receive a \$1,000 annual retainer fee paid following the Board of Director's annual reorganization meeting.

Information regarding compensation for each director who served during 2008 follows:

| | Number of Days Served | | Compensation paid for service on a board committee | Name of Committee | Total Compensation Paid in 2008 |
|------------------|-----------------------|---------------------------|--|--------------------------|---------------------------------|
| | Board Meetings | Other Official Activities | | | |
| Bryan Ankenbauer | 10 | 10 | \$300 300 | Audit Planning | \$7,686 |
| Tim Dwyer | 10 | 10 | 300 300 | Board Policy Planning | 8,425 |
| Arlen Gilbertson | 11 | 26 | 300 300 | Board Policy Planning | 13,199 |
| Daryl Klein | 11 | 16 | 300 300 | Board Policy Planning | 9,835 |
| Jim Limke | 9 | 17 | 300 300 | Board Policy Planning | 9,265 |
| Phil Lowe | 10 | 6 | 300 300 | Audit Planning | 5,890 |
| Bill Ongstad | 11 | 17 | 300 300 | Audit Planning | 10,285 |
| Rollin Tonneson | 9 | 16 | 300 | Planning | 10,325 |
| Total | 81 | 118 | \$4,500 | | \$74,910 |

SENIOR OFFICERS

The senior officers include:

Claude Sem, President and Chief Executive Officer
 Becky Braaten, Insurance Coordinator
 Dave Brossart, Assistant Vice President, Credit
 Kent Huss, Chief Financial Officer
 Wade Iverson, Chief Appraiser/Facilities Manager
 Ross Johnson, Vice President Agribusiness Finance
 Paul Klingbeil, Chief Information Officer
 John Stevenson, Vice President, Credit
 Leigh Wagner, Assistant Vice President, Sales Manager

All of the senior officers have been with Farm Credit Services of North Dakota, ACA for the past five years except for Mr. Klingbeil. Prior to beginning his employment with us in 2004, Mr. Klingbeil's business experience was in information technology for a healthcare provider.

A summary of compensation paid to the most highly compensated officers, including the senior officers previously noted follows (in thousands):

| | Year | Salary | Bonus | Deferred/ Perquisites | Other | Total |
|---|------|--------|-------|--------------------------|-------|---------|
| CEO | | | | | | |
| Claude Sem | 2008 | \$187 | \$64 | \$1 | \$ -- | \$252 |
| Claude Sem | 2007 | 175 | 64 | 1 | -- | 240 |
| Claude Sem | 2006 | 169 | 66 | -- | -- | 235 |
| Aggregate Number of Individuals (does not include CEO compensation) | | | | | | |
| Ten | 2008 | \$798 | \$339 | \$4 | \$ -- | \$1,141 |
| Eight | 2007 | 605 | 178 | 4 | -- | 787 |
| Nine | 2006 | 655 | 197 | 2 | -- | 854 |

Members may request information on the compensation paid during 2008 to the individuals listed in the preceding table.

CEO incentive pay is paid annually based on performance criteria established by the Board of Directors. Other senior officer incentive pay is paid annually based on performance criteria established by the CEO. The criteria include loan volume, related services, various financial and credit ratios, personal objectives and performance ratings. Incentives are calculated after the end of the plan year (the plan year is the calendar year) and are paid out within 90 days of year end.

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 Post Office Box 70, Minot, North Dakota 58702-0070, (701) 852-1265, or via electronic mail to info@farmcreditnd.com or through our website at www.farmcreditnd.com.

The total directors' travel, subsistence and other related expenses were \$66 thousand in 2008, \$71 thousand in 2007, and \$68 thousand in 2006.

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, 2009 or at any time during 2008.

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 2008 to our independent auditors were \$20 thousand for audit services. We also had \$4 thousand of fees paid to another qualified public accountant for tax 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.

Farm Credit Services of North Dakota, ACA

Funds Held Policy

Objective:

To allow members the opportunity to deposit funds in excess of regular loan payments in a funds held account.

Maximum Deposit Balance:

Mortgage Loans: The funds held balance may not exceed the unpaid principal balance of the outstanding balance on the related loan.

Commercial Loans: The funds held balance may not exceed the amount of the borrower's outstanding loan commitments. The outstanding commitments must be based upon historic or reasonably projected borrowing needs for the entity during the current operating cycle.

Loans with Prepayment Penalties (Mortgage or Commercial): On loans with prepayment penalties, the maximum allowed funds held on that particular loan is limited to 10% of the original commitment or the limits for mortgage and commercial loans as set forth above, whichever is the lesser amount.

Interest Rate:

The funds held interest rate will be a fixed rate based on the Association average MCD and adjusted monthly. Effective April 1, 2009, the funds held interest rate will be a fixed rate priced at 50 basis points below the Association average MCD and adjusted monthly. The rate paid will not exceed the rate charged on the related loan at any time.

Deposits:

Deposits may be made at any time. Money received after the billing of a scheduled payment (generally 30 days), but prior to a payment due date will be applied directly to the billed payment and will not earn interest. In all other cases, money deposited into funds held will earn interest from the day deposited until the day withdrawn.

Withdrawals:

Money in a funds held account may be available to be returned to borrowers, upon request, for an eligible loan purpose in lieu of increasing the borrower's loan. Twelve withdrawals per year are allowed per borrower/entity from the funds held account. The minimum withdrawal amount is \$500.00. Management has the authority to apply limitations to withdrawals or decline withdrawal requests if it adversely affects the credit.

Rate Changes:

Regulations do not require disclosure when funds held rates change. Customers will be notified of funds held rate changes via the statement of account.

Uninsured Account:

Funds held is not a depository account and is not insured by an agency of the federal government. In the event of Association liquidation, customers having balances in funds held shall be notified according to regulations.



**PRESORTED
STANDARD
U.S. POSTAGE PAID
PERMIT NO. XXXX
MINNEAPOLIS, MN**

Farm Credit Services of North Dakota, ACA

Post Office Box 70 • Minot, North Dakota 58702-0070 • (701) 852-1265

Visit us at www.farmcreditnd.com