

HERITAGE LAND BANK, ACA

2008 Quarterly Report First Quarter



For the Quarter Ended March 31, 2008

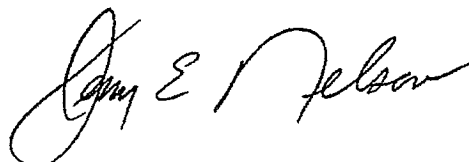
REPORT OF MANAGEMENT

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



Stephen R. Ogletree, Chief Executive Officer

May 5, 2008



Jerry Nelson, Chairman, Audit Committee

May 5, 2008



Jenny Sloan, Chief Financial Officer

May 5, 2008

**HERITAGE LAND BANK, ACA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Heritage Land Bank, ACA (Agricultural Credit Association), referred to as the Association, for the quarter and three months ended March 31, 2008. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2007 Annual Report of the Association.

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

Loan Portfolio:

Total loans outstanding at March 31, 2008, including nonaccrual loans and sales contracts, were \$426,603,707 compared to \$414,045,961 at December 31, 2007, reflecting an increase of 3.0 percent. Nonaccrual loans as a percentage of total loans outstanding were 1.4 percent at March 31, 2008, compared to 1.4 percent at December 31, 2007.

Risk Exposure:

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

	March 31, 2008		December 31, 2007	
	Amount	%	Amount	%
Nonaccrual	\$ 5,832,392	67.5%	\$ 5,887,850	86.3%
90 days past due and still accruing interest	2,648,923	30.6%	511,968	7.5%
Other property owned, net	165,163	1.9%	419,250	6.2%
Total	<u>\$ 8,646,478</u>	<u>100.0%</u>	<u>\$ 6,819,068</u>	<u>100.0%</u>

The increase of \$1,827,410 from December 31, 2007 is primarily related to 3 loans totaling \$1,907,345 that are classed 90 days past due and still accruing interest. One of the loans for \$500,041 is in the process of renewal and the other two loans for \$1,407,304 are in the process of being paid off.

Results of Operations:

For the Three Months Ended March 31, (\$ in thousands)				
	2008	2007	\$ Change	% Change
Net Interest Income	\$ 3,013	\$ 2,938	\$ 75	2.6%
Loan Loss Reversal	0	55	(55)	(100.0%)
Noninterest Income	1,021	759	262	34.5%
Noninterest Expense	(1,428)	(1,344)	(84)	6.3%
Net Income	<u>\$ 2,606</u>	<u>\$ 2,408</u>	<u>\$ 198</u>	<u>8.2%</u>
Average Loan Volume	\$ 419,134	\$ 371,166	\$ 47,968	12.9%
Average Direct Loan	363,226	318,521	44,705	14.0%
Interest Rate Spread	2.17	2.40	(0.23)	(9.6%)
Return on Assets	2.41	2.52	(0.11)	(4.4%)
Return on Equity	16.57	17.12	(0.55)	(3.2%)

The Association had net income of \$2,605,755 for the three months ended March 31, 2008, as compared to net income of \$2,408,047 for the same period in 2007 reflecting an increase of \$197,708 or 8.2 percent. This increase was primarily due to higher noninterest income of \$261,693 in 2008. The increase in noninterest income was mainly due to the increase in patronage income of \$152,838 which is attributable to a larger accrual of direct loan patronage from the Bank. The accrual is based on a return of 30 basis points in 2008 versus 20 basis points in 2007. The increase in noninterest income is also related to more loan servicing fees collected in 2008 from interest rate conversions resulting from the drop in interest rates, a gain on the sale of two properties acquired by the Association through foreclosure, and a gain on the sale of an Association vehicle.

The increase in net interest income for the three months ended March 31, 2008, as compared to the same periods in 2007 was primarily due to the growth in average loan volume of \$48.0 million, despite the decrease in net interest spread of 23 basis points. The decrease in net interest spread is attributable to a philosophy change by the Association to market pricing of loans based on the

actual risk in the loans and the increase in nonaccrual loans of \$5.3 million in the first quarter of 2008 as compared to the first quarter of 2007.

Noninterest expense increased \$83,666 or 6.3% for the three months ended March 31, 2008 as compared to the same periods in 2007. The increase is primarily related to the increase in salaries and benefits of \$103,790. Salaries increased \$39,068 or 6.7 percent and employee benefits increased \$64,722 or 34.6 percent. Increase in employee benefits is mainly due to the higher defined benefit pension plan contribution for 2008.

The Association's return on average assets for the three months ended March 31, 2008, was 2.41 compared to 2.52 percent for the same period in 2007. The Association's return on average equity for the three months ended March 31, 2008, was 16.57 compared to 17.12 percent for the same period in 2007.

Liquidity and Funding Sources:

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

	March 31, 2008	December 31, 2007
Note payable to the Bank	\$ 370,108,302	\$ 358,436,126
Accrued interest on note payable	1,485,390	1,618,578
Total	<u>\$ 371,593,692</u>	<u>\$ 360,054,704</u>

Capital Resources:

The Association's capital position increased by \$1,647,372 at March 31, 2008, compared to December 31, 2007. The Association's debt as a percentage of members' equity was 5.88:1 as of March 31, 2008, compared to 5.85:1 as of December 31, 2007.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at March 31, 2008, was 13.0 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at March 31, 2008, were 12.4 and 12.4 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

Relationship with the Farm Credit Bank of Texas:

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2007 Annual Report of Heritage Land Bank, ACA more fully describe the Association's relationship with the Bank.

The Tenth Farm Credit District's (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at fcf@farmcreditbank.com. The District makes its annual and quarterly stockholder reports available on its web site at www.farmcreditbank.com. The Association's annual and quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Heritage Land Bank, ACA, 4608 Kinsey Drive, Suite 100, Tyler, Texas 75711 or calling 903-534-4975. The Association also makes its annual and quarterly stockholder reports available on its Web site at www.heritagelandbank.com.

Subsequent Event:

During the third quarter 2007, the Association identified two loans to one entity that were deemed to be nonaccrual due to significant operating losses experienced by the entity over the past 18 months. The Association purchased a percentage of these loans from another Farm Credit Association in 2005. The Association's portion of these loans have a combined balance of \$4.4 million at March 31, 2008. A specific bad debt reserve totaling \$400,000 was recorded by the Association during the fourth quarter 2007. An additional specific reserve was recorded by the Association in April 2008 making the total reserve be \$985,000. The adjustment was based on a revised collateral assessment prepared by the originating Farm Credit Association. The originating Farm Credit Association is working with this entity as it develops a plan for repayment or refinance of the debt.

HERITAGE LAND BANK, ACA
CONSOLIDATED BALANCE SHEET

	March 31, 2008 (unaudited)	December 31, 2007
<u>ASSETS</u>		
Cash	\$ 919,804	\$ 721,070
Loans	426,603,707	414,045,961
Less: allowance for loan losses	(903,855)	(903,855)
Net loans	425,699,852	413,142,106
Accrued interest receivable	4,652,184	4,021,640
Investment in and receivable from the Bank:		
Capital stock	6,567,985	6,567,985
Other	427,500	665,870
Other property owned, net	165,163	419,250
Premises and equipment	1,808,004	1,769,446
Other assets	454,830	119,744
Total assets	\$ 440,695,322	\$ 427,427,111
 <u>LIABILITIES</u>		
Note payable to the Bank	\$ 370,108,302	\$ 358,436,126
Accrued interest payable	1,485,390	1,618,578
Drafts outstanding	231,912	399,152
Patronage distributions payable	3,816,136	2,863,250
Other liabilities	1,016,490	1,720,285
Total liabilities	376,658,230	365,037,391
 <u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	2,669,920	2,655,875
Allocated retained earnings	6,552,932	6,558,253
Unallocated retained earnings	54,279,365	52,632,017
Accumulated other comprehensive income	534,875	543,575
Total members' equity	64,037,092	62,389,720
Total liabilities and members' equity	\$ 440,695,322	\$ 427,427,111

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF INCOME
(unaudited)

	For the Three Months Ended March 31,	
	2008	2007
<u>INTEREST INCOME</u>		
Loans	\$ 7,562,915	\$ 7,303,163
<u>INTEREST EXPENSE</u>		
Note payable to the Bank	4,550,164	4,364,726
Net interest income	3,012,751	2,938,437
<u>PROVISION FOR LOSSES</u>		
Loan loss reversal	-	(54,633)
Net interest income after loan loss reversal	3,012,751	2,993,070
<u>NONINTEREST INCOME</u>		
Patronage income	557,046	404,208
Loan fees	390,896	313,445
Financially related services income	5,008	2,612
Gain (loss) on other property owned, net	30,538	(578)
Gain on sale of premises and equipment, net	8,037	13
Other noninterest income	29,201	39,333
Total noninterest income	1,020,726	759,033
<u>NONINTEREST EXPENSES</u>		
Salaries and employee benefits	872,710	768,920
Directors' expense	47,701	42,073
Purchased services	77,498	99,718
Travel	40,506	35,036
Occupancy and equipment	71,783	69,566
Communications	17,305	25,316
Advertising	24,239	40,018
Public and member relations	45,450	45,240
Supervisory and exam expense	35,035	30,701
FCSIC insurance expense	155,873	146,978
Other noninterest expense	39,622	40,490
Total noninterest expenses	1,427,722	1,344,056
Net income	\$ 2,605,755	\$ 2,408,047

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY
(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2006	\$ 2,529,380	\$ 6,576,256	\$ 46,002,202	\$ -	\$ 55,107,838
Net income	-	-	2,408,047	-	2,408,047
Capital stock/participation certificates issued	213,310	-	-	-	213,310
Capital stock/participation certificates retired	(187,875)	-	-	-	(187,875)
Patronage Cash Accrual	-	-	(627,500)	-	(627,500)
Balance at March 31, 2007	<u>\$ 2,554,815</u>	<u>\$ 6,576,256</u>	<u>\$ 47,782,749</u>	<u>\$ -</u>	<u>\$ 56,913,820</u>
Balance at December 31, 2007	\$ 2,655,875	\$ 6,558,253	\$ 52,632,017	\$ 543,575	\$ 62,389,720
Comprehensive income					
Net income	-	-	2,605,755	-	2,605,755
Other comprehensive income					
Prior service credits	-	-	-	(8,782)	(8,782)
Actuarial losses	-	-	-	82	82
Other comprehensive income	-	-	-	(8,700)	(8,700)
Comprehensive income	-	-	2,605,755	(8,700)	2,597,055
Effects of accounting change regarding measurement date of postretirement benefits plans pursuant to FASB Statement No. 158					
Service and interest costs for October 1-December 31	-	-	(14,221)	-	(14,221)
Amortization of prior service credits for October 1-December 31	-	-	8,782	-	8,782
Additional net loss, October 1-December 31	-	-	(82)	-	(82)
Net effects of accounting change	-	-	(5,521)	-	(5,521)
Capital stock/participation certificates issued	122,380	-	-	-	122,380
Capital stock/participation certificates and allocated retained earnings retired	(108,335)	(5,321)	-	-	(113,656)
Patronage Cash Accrual	-	-	(952,886)	-	(952,886)
Balance at March 31, 2008	<u>\$ 2,669,920</u>	<u>\$ 6,552,932</u>	<u>\$ 54,279,365</u>	<u>\$ 534,875</u>	<u>\$ 64,037,092</u>

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

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

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Heritage Land Bank, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Dallas, Tarrant, Collin, Hunt, Rockwall, Smith, Henderson, Rusk, Cherokee, Anderson, Nacogdoches, Panola, Sabine, Angelina, San Augustine and Shelby in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

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

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter and the three months ended March 31, 2008, are not necessarily indicative of the results to be expected for the year ended December 31, 2008.

NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

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

	March 31, 2008	March 31, 2007
Balance at beginning of quarter	\$ 903,855	\$ 492,061
Provision for loan losses	-	(54,633)
Charge-offs	-	(13,360)
Recoveries	-	-
Balance at end of quarter	<u>\$ 903,855</u>	<u>\$ 424,068</u>

The following table presents information concerning impaired loans:

	March 31, 2008	March 31, 2007
Impaired loans with related allowance	\$ 2,956,044	\$ 27,350
Impaired loans with no related allowance	5,525,271	469,743
Total impaired loans	<u>\$ 8,481,315</u>	<u>\$ 497,093</u>
Allowance on impaired loans	\$ 725,000	\$ 233,000
Average impaired loans	\$ 8,641,838	\$ 451,495
Interest income on impaired loans for the quarter	\$ 56,788	\$ 22,555

NOTE 3 — CAPITAL:

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

NOTE 4 — INCOME TAXES:

Heritage Land Bank, ACA and its subsidiary, Heritage Production Credit, PCA (Associations) are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. The Association had no tax provision or benefit recognized in 2007 or for the three months ended March 31, 2008.

Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. However, a valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. For the three months ended March 31, 2008, and 2007, the Association carries a deferred tax asset of \$492,386 and \$486,705 respectively, with a full valuation allowance recorded against the asset each year.

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

NOTE 5 — EMPLOYEE BENEFIT PLANS:

The Association previously disclosed in its financial statements for the year ended December 31, 2007, that it expected to contribute \$20,628 to its health and welfare plan in 2008. As of March 31, 2008, \$5,126 of contributions have been made. The Association presently anticipates contributing an additional \$14,190 to fund its health and welfare plan in 2008 for a total \$19,316. The unfunded accumulated benefit obligation at March 31 2008 was \$603,031.