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Our Mission

*To continue the HERITAGE of providing
superior service and
competitive financial products
while returning value to our shareholders*

On behalf of the Board of Directors, management and staff, I am pleased to provide you with the Heritage Land Bank, ACA 2008 Annual Report.

Heritage Land Bank had another good year with earnings of over \$6.6 million. Total assets grew \$34 million or over 8 percent for the year. Your Board of Directors approved paying out \$3.0 million in cash patronage during 2008 which marks the fifteenth consecutive year of refunding cash back to our stockholders in the form of patronage. The long-term commitment of refunding cash back to our stockholders is one of the many features which sets Heritage Land Bank apart from commercial banks and other lenders.

We continue to strengthen our donations to benefit non-profit community organizations and scholarship donations to area youth who are continuing their education and pursuing agricultural related degrees.

We will continue to provide you with professional, personable and knowledgeable service. We thank you for choosing Heritage Land Bank as your lender and wish you a very prosperous year in 2009.

Sincerely,

Stephen R. Ogletree
Chief Executive Officer


REPORT OF MANAGEMENT

The consolidated financial statements of Heritage Land Bank, ACA (Association) are prepared by management, who are responsible for the statements' 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 appropriate in the circumstances. Other financial information included in the annual report is consistent with that in the consolidated financial statements.

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

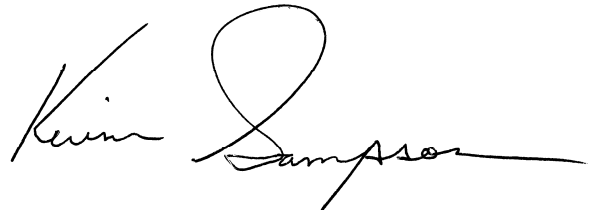
The board of directors has overall responsibility for the Association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

The undersigned certify that this annual report has been reviewed and 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 or belief.



Stephen Ogletree, Chief Executive Officer

March 3, 2009



Kevin Sampson, Chairman, Board of Directors

March 3, 2009



Jenny Sloan, Chief Financial Officer

March 3, 2009

REPORT OF AUDIT COMMITTEE

The Audit Committee (Committee) is composed of four members of the board of directors of Heritage Land Bank, ACA. In 2008, four committee meetings were held. The Committee oversees the scope of Heritage Land Bank, ACA's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on Heritage Land Bank, ACA's web site. The Committee approved the appointment of PricewaterhouseCoopers LLP for 2008.

Management is responsible for Heritage Land Bank, ACA's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the Committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of Heritage Land Bank, ACA's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The Committee's responsibilities include monitoring and overseeing the processes.

In this context, the Committee reviewed and discussed Heritage Land Bank, ACA's audited consolidated financial statements for the year ended December 31, 2008 (Audited Financial Statements) with management and PricewaterhouseCoopers LLP. The Committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communication With Those Charged With Governance) and both PricewaterhouseCoopers LLP and Heritage Land Bank, ACA's internal auditors directly provide reports on significant matters to the Committee.

The Committee discussed with PricewaterhouseCoopers LLP its independence from Heritage Land Bank, ACA. The Committee also reviewed the non-audit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The Committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the Committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the board of directors include the audited consolidated financial statements in Heritage Land Bank, ACA's Annual Report to Stockholders for the year ended December 31, 2008.

Audit Committee Members

Jerry Nelson, Chairman
Jack Pullen
George Hodges
David Alders

March 3, 2009

HERITAGE LAND BANK, ACA

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
	2008	2007	2006	2005	2004
<u>Balance Sheet Data</u>					
<u>Assets</u>					
Loans	\$ 449,888	\$ 414,046	\$ 364,755	\$ 286,168	\$ 256,383
Less: allowance for loan losses	(1,856)	(904)	(492)	(537)	(613)
Net loans	448,032	413,142	364,263	285,631	255,770
Investment in and receivable from the Bank	8,192	7,234	6,049	4,371	3,919
Other property owned, net	-	419	42	-	-
Other assets	5,665	6,632	5,837	4,525	4,342
Total assets	\$ 461,889	\$ 427,427	\$ 376,191	\$ 294,527	\$ 264,031
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 5,212	\$ 4,983	\$ 7,120	\$ 5,111	\$ 3,718
Obligations with maturities greater than one year	390,398	360,054	313,963	238,523	213,218
Total liabilities	395,610	365,037	321,083	243,634	216,936
<u>Members' Equity</u>					
Capital stock and participation certificates	2,682	2,656	2,530	2,405	2,246
Allocated retained earnings	6,543	6,558	6,576	3,658	-
Unallocated retained earnings	56,597	52,632	46,002	44,830	44,849
Accumulated other comprehensive income	457	544	-	-	-
Total members' equity	66,279	62,390	55,108	50,893	47,095
Total liabilities and members' equity	\$ 461,889	\$ 427,427	\$ 376,191	\$ 294,527	\$ 264,031
Year Ended December 31,					
<u>Statement of Income Data</u>					
Net interest income	\$ 11,970	\$ 11,854	\$ 10,241	\$ 8,856	\$ 8,054
(Provision for loan losses) or loan loss reversal	(2,966)	(490)	15	(45)	5,787
Income from the Bank	2,163	1,953	1,767	902	786
Other noninterest income	1,379	1,380	1,537	948	951
Noninterest expense	(5,928)	(5,204)	(5,092)	(5,034)	(5,658)
Net income	\$ 6,618	\$ 9,493	\$ 8,468	\$ 5,627	\$ 9,920
<u>Key Financial Ratios for the Year</u>					
Return on average assets	1.5%	2.4%	2.6%	2.1%	4.1%
Return on average members' equity	10.2%	16.1%	15.4%	11.3%	24.1%
Net interest income as a percentage of average earning assets	2.7%	3.1%	3.2%	3.4%	3.4%
Net charge-offs as a percentage of average loans	0.5%	0.0%	0.0%	0.0%	0.1%

HERITAGE LAND BANK, ACA

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
2008	2007	2006	2005	2004	
<u>Key Financial Ratios at Year End</u>					
Members' equity as a percentage of total assets	14.3%	14.6%	14.6%	17.2%	17.8%
Debt as a percentage of members' equity	596.9%	585.1%	569.7%	468.7%	452.7%
Allowance for loan losses as a percentage of loans	0.4%	0.2%	0.1%	0.2%	0.2%
Permanent capital ratio	12.8%	13.3%	14.6%	17.2%	16.5%
Core surplus ratio	12.2%	12.7%	14.0%	16.3%	15.6%
Total surplus ratio	12.2%	12.7%	14.0%	16.3%	15.6%
<u>Net Income Distribution</u>					
Patronage refunds:					
Cash	\$ 3,047	\$ 4,396	\$ 1,970	\$ 1,719	\$ 900
Allocated retained earnings	-	-	2,918	3,658	-

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Heritage Land Bank, ACA, including its wholly-owned subsidiaries, Heritage Production Credit, PCA and Heritage Land Bank, FLCA (Association) for the years ended December 31, 2008, 2007 and 2006, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the Association's Audit Committee.

Forward-Looking Information:

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

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

Significant Events:

In December 2008, the Association received a direct loan patronage of \$1,136,380 from the Bank, representing 30 basis points on the average daily balance of the Association's direct loan with the Bank. During 2008, the Association received \$305,461 in interest credit patronage payments from the Bank, based on the Association's stock investment in the Bank. Also, the Association received a capital markets patronage of \$668,384 from the Bank, representing 65 basis points on the year's average daily balance of participations in capital markets loans with patronage commitments.

Nonaccrual loan volume increased \$9,259,254 from \$5,887,850 at December 31, 2007 to \$15,147,104 at December 31, 2008. Increase in nonaccrual volume is primarily related to several large loans to entities where that experienced adverse financial trends or where the entities had reported operating losses in 2008. Association management is working with these entities to arrive at financial solutions that will result in the least negative impact on the Association. Further discussion of these loans is included in this section under the headings of Risk Exposure, Results of Operations and under Note 3 to the consolidated financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, adjustable and prime-based interest rates. Loan maturities range from one to 30 years, with annual operating loans comprising the majority of the commercial loans and 15- to 25-year maturities comprising the majority of the mortgage loans. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The loan portfolio owned by the Association, including principal less funds held of \$449,887,810, \$414,045,961 and \$364,754,535 as of December 31, 2008, 2007 and 2006, respectively, is described more fully in detailed tables in Note 3 to the consolidated financial statements, "Loans and Allowance for Loan Losses," included in this annual report.

Purchase and Sales of Loans:

During 2008, 2007 and 2006, the Association was participating in loans with the Bank and other District associations. As of December 31, 2008, 2007 and 2006, these participations totaled \$48,179,179, \$45,550,625 and \$48,631,212, or 10.7 percent, 11.0 percent and 13.3 percent of loans, respectively. Included in these amounts is a participation purchased from an entity outside the

District of \$945,494, \$1,000,000, and \$1,000,000 or 0.2 percent of loans for all three years respectively. The Association has also sold participations of \$135,512,702, \$123,198,875, and \$111,537,807 as of December 31, 2008, 2007, and 2006, respectively.

Risk Exposure:

High-risk assets include nonaccrual loans, loans which are past due 90 days or more and still accruing interest, formally restructured loans and other property owned, net. The following table illustrates the Association's components and trends of high-risk assets serviced for the prior three years as of December 31:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 15,147,104	94.6%	\$ 5,887,850	86.3%	\$ 863,575	95.4%
90 days past due and still accruing interest	859,545	5.4%	511,968	7.5%	-	0.0%
Other property owned, net	-	0.0%	419,250	6.2%	41,860	4.6%
Total	\$ 16,006,649	100.0%	\$ 6,819,068	100.0%	\$ 905,435	100.0%

At December 31, 2008, 2007 and 2006, loans that were considered impaired were \$16,006,649, \$6,399,818 and \$863,575, representing 3.6 percent, 1.5 percent and 0.2 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net.

The increase in impaired loans in 2008 is primarily related to five large loans with a total outstanding balance at December 31, 2008 of \$9.2 million. Two of the large loans are to one borrower for a total of \$1.1 million and are more than 180 days past due. These two loans are in the process of collection with a plan to bring current or pay off in 2009. Another loan for \$4.6 million at December 31, 2008 was placed into nonaccrual when the borrowing entity filed bankruptcy in December 2008. This loan was purchased from another Farm Credit association which is currently working on a restructuring plan with the borrowing entity. The last two large loans for \$3.5 million are to one borrowing entity that has incurred significant operating losses due to the downturn in the beef cattle industry. These loans were 60 days past due at December 31, 2008 and are in the process of collection and anticipated to be paid off in 2009. As of December 31, 2008, no reserves have been recorded related to these loans since the net realizable value of the underlying collateral exceeds the debt for each loan.

The increase in impaired loans from 2006 to 2007 was mainly related to two loans made to one entity with an outstanding balance of \$4.5 million at December 31, 2007. These loans were purchased as a participation interest from another Farm Credit association in 2005 and were considered impaired in 2007 because of significant operating losses experienced by the entity. These loans are still considered impaired in 2008 with an outstanding balance of \$3.9 million at December 31, 2008. The Association and the originating Farm Credit association are working with this entity to restructure the debt in conjunction with obtaining a loan guarantee from the federal government.

The Association is not significantly affected by seasonal characteristics or other factors which would affect most agricultural lenders because of the availability of nonfarm income sources for repayment for the majority of the Association's borrowers.

Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	2008	2007	2006
Allowance for loan losses	\$ 1,856,351	\$ 903,855	\$ 492,061
Provision for loan losses (provision reversal)	2,966,448	489,842	(14,887)
Loans charged off	(2,020,908)	(78,837)	(29,716)
Recoveries	6,956	789	-
Allowance for loan losses to total loans	0.4%	0.2%	0.1%
Allowance for loan losses to nonaccrual loans	12.3%	15.4%	57.0%
Allowance for loan losses to impaired loans	11.6%	14.1%	57.0%
Net charge-offs to average loans	0.5%	0%	0%

The allowance for loan losses is maintained based upon estimates that consider the general financial strength of the agricultural economy, loan portfolio composition, credit administration and the portfolio's prior loan loss experience. Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$1,856,351, \$903,855 and

\$492,061 at December 31, 2008, 2007 and 2006, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates.

The increase in nonaccrual loans does not necessarily correlate to an increase in the allowance for loan losses. As loans are considered impaired, management evaluates the exposure to the Association based on the net recovery value of the underlying collateral and records reserves if needed. The evaluation on the loans discussed above related to the increase in nonaccrual loan volume, did not indicate any additional reserves were necessary. However, noted weaknesses in the general economy, including the significant slowdown in the residential real estate market and recent weaknesses in the job market, as well as the increase in the Association's nonaccrual loans, have caused some concern for management when evaluating its allowance for loan losses. While land values in the Association's territory have not declined, management believes it prudent to allow for a potential deterioration in credit quality. Management has taken steps to increase its allowance for loan losses by \$952,496 in 2008.

Results of Operations:

For the Twelve Months Ended December 31,
(\$ in thousands)

	<u>2008</u>	<u>2007</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Net Interest Income	\$ 11,970	\$ 11,854	\$ 116	1.0%	\$ 11,854	\$ 10,241	\$ 1,613	15.8%
(Provision for Loan Losses)								
Provision Reversal	(2,966)	(490)	(2,476)	505.3%	(490)	15	(505)	-3366.7%
Noninterest Income	3,542	3,333	209	6.3%	3,333	3,305	28	0.8%
Noninterest Expense	(5,928)	(5,204)	(724)	13.9%	(5,204)	(5,093)	(111)	2.1%
Net Income	<u>\$ 6,618</u>	<u>\$ 9,493</u>	<u>\$ (2,875)</u>	<u>-30.3%</u>	<u>\$ 9,493</u>	<u>\$ 8,468</u>	<u>\$ 1,025</u>	<u>12.1%</u>
Return on Average Assets	1.48	2.40	(0.92)	-38.3%	2.40	2.60	(0.20)	-7.7%
Return on Average Equity	10.25	16.10	(5.85)	-36.4%	16.10	15.40	0.70	4.5%

The Association's net income for the year ended December 31, 2008, was \$6,618,439 as compared to \$9,493,065 for the year ended December 31, 2007, reflecting a decrease of \$2,874,626, or 30.3 percent. This decrease is primarily due to the provision for loan loss of \$2,966,448 versus \$489,842 in 2007 and an increase in noninterest expense of \$723,901. The Association's net income for the year ended December 31, 2006 was \$8,468,278. Net income increased \$1,024,787, or 12.1 percent, in 2007 versus 2006. The increase in 2007 was mainly due to an increase in net interest income of \$1,613,238, offset slightly by the increase in the provision for loan loss of \$504,729.

Net interest income for 2008, 2007 and 2006 was \$11,969,744, \$11,854,238 and \$10,241,000, reflecting increases of \$115,506, or 1.0 percent, for 2008 versus 2007 and \$1,613,238, or 15.8 percent, for 2007 versus 2006. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The increases in both years are due to increases in average loan volume of \$51.1 million in 2008 and \$63.4 million in 2007 offset somewhat by decreases in interest rate spread earned on the loan portfolio of 19 basis points in 2008 and 7 basis points in 2007. Competition within the lending industry has caused compression in spreads on loans within the Association's mortgage and capital markets portfolios. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

For the Twelve Months Ended December 31,
(\$ in thousands)

	<u>2008</u>	<u>2007</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Average loan volume	\$435,897	\$384,756	\$51,141	13.3%	\$384,756	\$321,350	\$63,406	19.7%
Average direct loan	\$378,811	\$332,299	\$46,512	14.0%	\$332,299	\$272,772	\$59,527	21.8%
Yield on loans	6.79%	7.83%	-1.04%	-13.3%	7.83%	7.58%	0.25%	3.3%
Cost of direct note	4.65%	5.50%	-0.85%	-15.4%	5.50%	5.18%	0.32%	6.2%
Interest rate spread	2.14%	2.33%	-0.19%	-8.2%	2.33%	2.40%	-0.07%	-3.0%

2008 vs. 2007
Increase (decrease) due to
(\$ in Thousands)

2007 vs. 2006
Increase (decrease) due to
(\$ in Thousands)

	<u>Volume</u>	<u>Rate</u>	<u>Total</u>	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
Interest Income	\$ 4,004	\$ (4,548)	\$ (544)	\$ 4,807	\$ 955	\$ 5,762
Interest Expense	2,558	(3,218)	(660)	3,082	1,067	4,149
Net Interest Income	<u>\$ 1,447</u>	<u>\$ (1,331)</u>	<u>\$ 116</u>	<u>\$ 1,725</u>	<u>\$ (112)</u>	<u>\$ 1,613</u>

In 2008, a provision for loan losses was recorded for \$2,966,448. The majority of the provision is comprised of specific reserves recorded in 2008 on 3 loans to two borrowing entities totaling \$2,390,000. Specific reserves are based on outstanding loan balances versus recovery value of the underlying collateral. A reserve was recorded in 2008 related to two of these loans to one borrowing entity for \$795,000. The reserve was based on a revised collateral assessment in 2008. The Association is working with this entity to restructure the debt in conjunction with a loan guarantee from the federal government.

The second entity has one loan which was put into nonaccrual in 2008 due to recent operating losses and past due amounts. A specific reserve was recorded for \$1,595,000 as the loan is determined to be undersecured. Because of this entity's current inability to repay the debt and since its operating losses were expected to continue, the loan balance was charged off as of December 31, 2008.

In 2007, a provision for loan losses was recorded for \$489,842. The majority of the provision is comprised of specific reserves related to two borrowers with total debt at December 31, 2007 of \$5.3 million.

Noninterest income for 2008 increased by \$210,375, or 6.3 percent, compared to 2007, due primarily to an increase in the patronage received from the Bank of \$157,530. The increase in patronage is due to the growth in the average note payable to the Bank of \$46.5 million. The increase is also due to the net gain on the sale of owned property for \$105,865. Noninterest income for 2007 increased by only \$27,845, or 0.8 percent, compared to 2006.

Noninterest expenses consist primarily of salaries, employee benefits, purchased services, and Insurance Fund premiums. Expenses for purchased services may include administrative services, marketing, information systems, accounting and auditing, among others. Noninterest expenses increased in 2008 by \$723,901, or 13.9% and by \$111,567, or 2.2% in 2007. The increase in 2008 is primarily due to an increase in salaries of \$167,389 related to employee additions to support Association growth and annual salary adjustments, a higher defined benefit pension plan contribution of \$265,457, and an increase in advertising expenses of \$80,833 in an attempt to reach a broader market at all branch locations.

For the year ended December 31, 2008, the Association's return on average assets was 1.5 percent, as compared to 2.4 percent and 2.6 percent for the years ended December 31, 2007 and 2006, respectively. For the year ended December 31, 2008, the Association's return on average members' equity was 10.2 percent, as compared to 16.1 percent and 15.4 percent for the years ended December 31, 2007 and 2006, respectively. The decrease in the returns on average assets and average members' equity in 2008 are attributable to the reduced net earnings of the Association because of the provision for loan losses taken as discussed above in the Allowance for Loan Loss section of this report.

Because the Association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank would have a similar effect on the operations of the Association.

Liquidity and Funding Sources:

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$388,967,769, \$358,436,126 and \$312,546,213 as of December 31, 2008, 2007 and 2006, respectively, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 4.22 percent, 5.42 percent and 5.45 percent at December 31, 2008, 2007 and 2006, respectively. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2007, is due to the increase in borrowings to fund loan growth of \$35.8 million. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$60,924,522, \$55,440,806 and \$52,033,463 at December 31, 2008, 2007 and 2006, respectively. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$435,705,781 as defined by the general financing agreement.

The liquidity policy of the Association is to manage cash balances to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2009. As borrower payments are received, they are applied to the Association's note payable to the Bank.

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

Capital Resources:

The Association's capital position remains strong, with total members' equity of \$66,279,167, \$62,389,720 and \$55,107,838 at December 31, 2008, 2007 and 2006, respectively. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the Farm Credit Administration (FCA). The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The Association's permanent capital ratio at December 31, 2008, 2007 and 2006 was 12.8 percent, 13.3 percent and 14.6 percent, respectively. The core surplus ratio measures available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The Association's core surplus ratio at December 31, 2008, 2007 and 2006 was 12.2 percent, 12.7 percent and 14.0 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measures available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the reserves existing to protect borrowers' investment in the Association. The Association's total surplus ratio at December 31, 2008, 2007 and 2006 was 12.2 percent, 12.7 percent and 14.0 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent.

In 2008, 2007 and 2006, the Association paid patronage distributions of \$3,046,832, \$4,395,523 and \$1,969,645, respectively. In 2008, the board of directors approved a \$2,480,000 patronage distribution to be paid in March 2009. See Note 7 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

Relationship With the Bank:

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank's ability to access capital of the Association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 6 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The Bank provides computer systems to support the critical operations of all District associations. In addition, each Association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 10 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the Bank provides many services that the Association can utilize, such as administrative, marketing, information systems, and accounting services. Additionally, the Bank allocates District expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums.

Summary:

Over the past 91 years, regardless of the state of the agricultural economy, your Association's board of directors and management, as well as the board of directors and management of the Bank, have been committed to offering their borrowers a ready source of financing at a competitive price. The Association has experienced strong earnings, portfolio growth and maintained good credit quality. With its strong capital position, oversight of the board of directors and leadership of senior management, the Association will maintain its current position as a leader of agricultural financing in its chartered territory. Your continued support will be critical to the success of this Association.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders
of Heritage Land Bank, ACA

In our opinion, the accompanying consolidated balance sheets and related consolidated statements of income, changes in members' equity and cash flows present fairly, in all material respects, the financial position of Heritage Land Bank, ACA and subsidiaries (Association) at December 31, 2008, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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

Austin, Texas
March 3, 2009

HERITAGE LAND BANK, A CA

CONSOLIDATED BALANCE SHEET

	December 31,		
	2008	2007	2006
<u>Assets</u>			
Cash	\$ 430,025	\$ 721,070	\$ 361,562
Loans	449,887,810	414,045,961	364,754,535
Less: allowance for loan losses	(1,856,351)	(903,855)	(492,061)
Net loans	448,031,459	413,142,106	364,262,474
Accrued interest receivable	3,335,641	4,021,640	3,577,155
Investment in and receivable from the Bank:			
Capital stock	7,523,170	6,567,985	5,322,945
Other	668,601	665,870	726,082
Other property owned, net	-	419,250	41,860
Premises and equipment	1,755,410	1,769,446	1,785,283
Other assets	144,352	119,744	113,841
Total assets	<u>\$ 461,888,658</u>	<u>\$ 427,427,111</u>	<u>\$ 376,191,202</u>
<u>Liabilities</u>			
Note payable to the Bank	\$ 388,967,769	\$ 358,436,126	\$ 312,546,213
Accrued interest payable	1,429,915	1,618,578	1,418,150
Drafts outstanding	844,144	399,152	591,184
Patronage distributions payable	2,480,000	2,863,250	4,377,520
Other liabilities	1,887,663	1,720,285	2,150,297
Total liabilities	<u>395,609,491</u>	<u>365,037,391</u>	<u>321,083,364</u>
<u>Members' Equity</u>			
Capital stock and participation certificates	2,682,325	2,655,875	2,529,380
Allocated retained earnings	6,542,952	6,558,253	6,576,256
Unallocated retained earnings	56,596,654	52,632,017	46,002,202
Accumulated other comprehensive income	457,236	543,575	-
Total members' equity	<u>66,279,167</u>	<u>62,389,720</u>	<u>55,107,838</u>
Total liabilities and members' equity	<u>\$ 461,888,658</u>	<u>\$ 427,427,111</u>	<u>\$ 376,191,202</u>

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF INCOME

	Year Ended December 31,		
	2008	2007	2006
<u>Interest Income</u>			
Loans	\$ 29,582,635	\$ 30,126,988	\$ 24,365,378
<u>Interest Expense</u>			
Note payable to the Bank	17,612,891	18,272,750	14,124,378
Net interest income	<u>11,969,744</u>	<u>11,854,238</u>	<u>10,241,000</u>
<u>Provision for Losses</u>			
Provision for loan losses or (loan loss reversal)	<u>2,966,448</u>	<u>489,842</u>	<u>(14,887)</u>
Net interest income after provision for loan losses	<u>9,003,296</u>	<u>11,364,396</u>	<u>10,255,887</u>
<u>Noninterest Income</u>			
Patronage income from the Bank	2,110,225	1,952,695	1,767,111
Patronage income from other Farm Credit Institutions	52,916	-	-
Loan fees	1,209,207	1,300,343	1,327,387
Financially related services income	11,619	10,049	13,530
Gain on other property owned, net	105,865	-	-
Gain on sale of premises and equipment, net	18,232	13	8,507
Other noninterest income	35,310	69,899	188,619
Total noninterest income	<u>3,543,374</u>	<u>3,332,999</u>	<u>3,305,154</u>
<u>Noninterest Expenses</u>			
Salaries and employee benefits	3,251,010	2,767,700	2,815,020
Directors' expense	179,081	135,202	155,902
Purchased services	433,481	441,626	445,103
Travel	166,053	168,034	182,768
Occupancy and equipment	315,454	300,547	296,349
Communications	68,767	76,141	76,635
Advertising	233,685	152,852	110,260
Public and member relations	289,526	249,631	243,409
Supervisory and exam expense	143,323	127,137	115,315
Insurance Fund premiums	655,285	610,042	466,822
Loss on other property owned, net	-	544	-
Other noninterest expense	192,566	174,874	185,180
Total noninterest expenses	<u>5,928,231</u>	<u>5,204,330</u>	<u>5,092,763</u>
Net income	<u>\$ 6,618,439</u>	<u>\$ 9,493,065</u>	<u>\$ 8,468,278</u>

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2005	\$ 2,405,725	\$ 3,657,908	\$ 44,829,792	\$ -	\$ 50,893,425
Net income	-	-	8,468,278	-	8,468,278
Capital stock/participation certificates issued	555,510	-	-	-	555,510
Capital stock/participation certificates retired	(431,855)	-	-	-	(431,855)
Patronage distribution declared		2,918,348	(7,295,868)		(4,377,520)
Balance at December 31, 2006	2,529,380	6,576,256	46,002,202	-	55,107,838
Net income	-	-	9,493,065	-	9,493,065
Adjustment to initially apply SFAS No. 158	-	-	-	543,575	543,575
Capital stock/participation certificates issued	640,605	-	-	-	640,605
Capital stock/participation certificates and allocated retained earnings retired	(514,110)	(18,003)	-	-	(532,113)
Patronage distribution declared	-	-	(2,863,250)	-	(2,863,250)
Balance at December 31, 2007	2,655,875	6,558,253	52,632,017	543,575	62,389,720
Adjustment to beginning balance due to SFAS No. 158 accounting change	-	-	(5,521)	-	(5,521)
Balance at January 1, 2008	2,655,875	6,558,253	52,626,496	543,575	62,384,199
Comprehensive income					
Net income	-	-	6,618,439	-	6,618,439
Change in pension and postretirement benefit plans	-	-	-	(86,339)	(86,339)
Total comprehensive income	-	-	6,618,439	(86,339)	6,532,100
Capital stock/participation certificates issued	452,565	-	-	-	452,565
Capital stock/participation certificates and allocated retained earnings retired	(426,115)	(15,301)	-	-	(441,416)
Patronage distribution declared	-	-	(2,648,281)	-	(2,648,281)
Balance at December 31, 2008	\$ 2,682,325	\$ 6,542,952	\$ 56,596,654	\$ 457,236	\$ 66,279,167

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income	\$ 6,618,439	\$ 9,493,065	\$ 8,468,278
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	2,966,448	489,842	(14,887)
Gain on other property owned	(110,822)	(3,101)	-
Depreciation	163,160	156,790	151,906
Gain on sale of premises and equipment, net	(18,232)	(13)	(8,507)
Decrease (increase) in accrued interest receivable	685,999	(444,485)	(1,358,430)
(Increase) decrease in other receivable from the Bank	(2,731)	60,212	(633,071)
(Increase) decrease in other assets	(24,608)	(5,903)	4,123
(Decrease) increase in accrued interest payable	(188,663)	200,428	530,391
Increase in other liabilities	75,518	113,563	220,536
Net cash provided by operating activities	<u>10,164,508</u>	<u>10,060,398</u>	<u>7,360,339</u>
Cash flows from investing activities:			
Increase in loans, net	(38,168,284)	(49,792,188)	(78,658,120)
Cash recoveries of loans previously charged off	6,956	789	-
Purchases of investment in the Bank	(955,185)	(1,245,040)	(1,045,250)
Purchases of premises and equipment	(155,767)	(156,249)	(108,138)
Proceeds from sales of premises and equipment	24,875	15,309	13,300
Proceeds from sales of other property owned	835,599	47,636	-
Net cash used in investing activities	<u>(38,411,806)</u>	<u>(51,129,743)</u>	<u>(79,798,208)</u>

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

HERITAGE LAND BANK, ACA

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
Cash flows from financing activities:			
Net draws on note payable to the Bank	30,531,643	45,889,913	74,910,883
Increase (decrease) in drafts outstanding	444,992	(192,032)	(620,023)
Issuance of capital stock and participation certificates	452,565	640,605	555,510
Retirement of capital stock and participation certificates	(426,115)	(514,110)	(431,855)
Patronage distributions paid	(3,031,531)	(4,377,520)	(1,969,645)
Allocated equities applied to loans	(15,301)	(18,003)	-
Net cash provided by financing activities	27,956,253	41,428,853	72,444,870
Net (decrease) increase in cash	(291,045)	359,508	7,001
Cash at the beginning of the year	721,070	361,562	354,561
Cash at the end of the year	\$ 430,025	\$ 721,070	\$ 361,562

Supplemental schedule of noncash investing and financing activities:

Loans transferred to other property owned	\$ 305,527	\$ 421,925	\$ 41,860
Loans charged off	2,020,908	78,837	29,716
Patronage distributions declared	2,648,281	2,863,250	7,295,868
Adjustment to initially adopt SFAS No. 158	5,521	543,575	-

Supplemental cash information:

Cash paid during the year for:			
Interest	\$ 17,801,553	\$ 18,072,322	\$ 13,594,837

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

HERITAGE LAND BANK, ACA
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND OPERATIONS:

- A. Organization: Heritage Land Bank, ACA, including its wholly-owned subsidiaries, Heritage Production Credit, PCA and Heritage Land Bank, FLCA (collectively called “the Association”), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in 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 (System), a nationwide system of cooperatively owned banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). The most recent significant amendment to the Act was the Agricultural Credit Act of 1987 (1987 Act). At December 31, 2008, the System consisted of four Farm Credit Banks and their affiliated associations, one Agricultural Credit Bank and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related associations are collectively referred to as the “District.” The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the district associations. At December 31, 2008, the District consisted of the Bank, 6 FLCAs and 13 ACA parent companies, which have two wholly-owned subsidiaries, a FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations, and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System bank has been required to pay premiums, which may be passed on to the associations into the Insurance Fund, based on its annual average loan principal outstanding, until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. At December 31, 2008 the assets in the Insurance Fund were approximately \$2.9 billion. In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each bank’s pro rata share of outstanding insured debt. The Farm Bill imposes premiums of 20 basis points on adjusted insured debt obligations, with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services that can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The Association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The Association's financial condition may be affected by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect stockholders' investment in the Association. Upon request, stockholders of the Association will be provided with the Tenth Farm Credit District's Annual Report to Stockholders, which includes the combined financial statements of the Bank and all of the district associations. The District's annual report discusses the material aspects of the financial condition, changes in financial condition, and results of operations for the Bank and the District. In addition, the District's annual report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Fund.

The Association also serves as an intermediary in offering credit life insurance to borrowers.

The lending and financial services offered by the Bank are described in Note 1 of the District's annual report to stockholders.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of the Association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. Certain amounts in prior years' consolidated financial statements have been reclassified to conform to current financial statement presentation. The consolidated financial statements include the accounts of Heritage Production Credit, PCA and Heritage Land Bank, FLCA. All significant intercompany transactions have been eliminated in consolidation.

- A. Cash and Cash Equivalents: Cash and cash equivalents, as included in the statement of cash flows, represent cash on hand and on deposit at local banks.
- B. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 5 years or less.

Loans are carried at their principal amount outstanding adjusted for charge-offs.

Statement of Financial Accounting Standards (SFAS) No. 91, "Accounting for Nonrefundable Fees and Costs Associated With Originating and Acquiring Loans and Initial Direct Costs of Leases," requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield. SFAS No. 91 has not been implemented because the effects were not material to the financial position or results of operations for any year presented.

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

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs 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." If previously unrecognized interest income exists upon transfer of a nonaccrual loan to accrual status, interest income will be recognized as cash payments are received.

Loans are charged off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable 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. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

- C. **Capital Stock Investment in the Bank:** The Association's investment in the Bank is in the form of Class A voting capital stock. This investment is adjusted periodically based on the Association's proportional utilization of the Bank compared to other district associations. The Bank requires a minimum stock investment of 2 percent of the Association's average borrowing from the Bank. This investment is carried at cost in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the Bank may increase the percentage of stock held by an association from 2 percent of the average outstanding balance of borrowings from the Bank to a maximum of 5 percent of the average outstanding balance of borrowings from the Bank.

- D. **Other Property Owned, Net:** Other property owned, net, consisting of real and personal property acquired through a collection action, is recorded at lower of carrying amount of loan or fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned, net.
- E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- F. **Advance Conditional Payments:** The Association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Advance conditional payments are not insured. Interest is generally paid by the Association on such accounts at rates established by the Board of Directors.
- G. **Employee Benefit Plans:** Employees of the Association participate in either the defined benefit retirement plan (DB Plan) or the defined contribution plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. The DB Plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB Plan is noncontributory and provides benefits based on salary and years of service. The "Projected Unit Credit" actuarial method is used for financial reporting and funding purposes for the DB Plan.

Participants in the DC Plan generally include employees who elected to transfer from the DB Plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC Plan direct the placement of their employers' contributions, 5.0 percent of salaries for the year ended December 31, 2008, made on their behalf into various investment alternatives.

The structure of the District's DB and DC plans are characterized as multi-employer, since neither the assets, liabilities nor costs of any plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plan. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The Association recognized pension costs for the DC Plan of \$65,302, \$70,679 and \$38,581 for the years ended December 31, 2008, 2007 and 2006, respectively. For the DB Plan, the Association recognized pension costs of \$421,088, \$155,631 and \$141,816 for the years ended December 31, 2008, 2007 and 2006, respectively.

The Association also participates in the Farm Credit Benefits Alliance 401(k) Plan which requires the associations to match 100 percent of employee contributions up to 3.0 percent of base salary and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of base salary. Association 401(k) plan costs are expensed as incurred. The Association's contributions to the 401(k) plan were \$56,798, \$59,907 and \$45,871 for the years ended December 31, 2008, 2007 and 2006, respectively.

In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities. To be eligible for the health and welfare benefits, an employee must have been hired prior to January 1, 2005, completed 10 years of service and be at least age 55. The employee can also qualify at age 50 but must have at least 30 years of service. In accordance with SFAS 106, "Employers Accounting For Postretirement Benefits Other Than Pensions," the Association recognizes the liability for the contractual obligation of these benefits as employees render the services necessary to earn the benefits.

- H. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax; however, the Association is exempt from state franchise taxes. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income. Deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.
- I. **Patronage Refunds From the Farm Credit Bank of Texas:** The Association estimates and accrues the direct note and capital markets patronage refunds from the Bank quarterly. The direct note patronage is paid by the Bank in December and the capital markets pool patronage is paid in January in the following year. The stock credit patronage is paid and recorded quarterly.
- J. **Fair Value Measurement:** Effective January 1, 2008, the System 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 describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

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

generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, and highly structured or long-term derivative contracts.

The adoption of FAS 157 has no effect on the Association's financial statements as no assets or liabilities are recorded at fair value.

- K. Recently Issued Accounting Pronouncements: In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under this Statement and related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Association does not expect adoption of SFAS No. 161 to have any impact on its financial statement disclosures.

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans as of December 31 follows:

Loan Type	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Real estate mortgage	\$ 339,077,382	75.4%	\$ 312,856,090	75.5%	\$ 278,366,973	76.3%
Production and intermediate term	61,707,999	13.7%	53,297,916	12.9%	43,874,715	12.0%
Agribusiness:						
Loans to cooperatives	363,061	0.1%	314,805	0.1%	617,602	0.2%
Processing and marketing	28,801,635	6.4%	30,244,868	7.3%	26,597,626	7.3%
Farm-related business	552,447	0.1%	564,869	0.1%	-	0.0%
Communication	2,202,801	0.5%	2,356,226	0.6%	5,253,618	1.4%
Rural residential real estate	17,182,486	3.8%	14,411,187	3.5%	10,044,001	2.8%
Total	<u>\$ 449,887,810</u>	<u>100.0%</u>	<u>\$ 414,045,961</u>	<u>100.0%</u>	<u>\$ 364,754,535</u>	<u>100.0%</u>

Geographic Distribution:

County	2008	2007	2006
Collin	13.9%	14.8%	14.2%
Hunt	10.5%	9.4%	9.1%
Smith	8.8%	9.4%	9.2%
Anderson	7.4%	8.6%	7.4%
Henderson	6.6%	6.4%	6.6%
Cherokee	5.5%	5.9%	6.5%
Nacogdoches	4.1%	3.4%	5.0%
Rockwall	3.7%	3.2%	1.6%
Grayson	2.9%	3.0%	2.8%
Dallas	2.6%	2.8%	4.7%
Fannin	2.1%	1.1%	1.3%
Shelby	2.1%	2.5%	3.2%
Hopkins	1.7%	1.9%	2.0%
Rusk	1.7%	2.1%	2.2%
Angelina	1.3%	1.4%	1.9%
King	1.3%	1.5%	0.0%
Denton	1.3%	1.0%	0.8%
Sabine	1.2%	1.3%	0.1%
Hill	1.1%	1.2%	0.8%
Camp	1.0%	0.7%	0.0%
Kaufman	0.9%	0.9%	1.0%
Nueces	0.9%	1.1%	1.2%
Panola	0.8%	0.7%	1.0%
Van Zandt	0.7%	0.9%	0.8%
Franklin	0.6%	0.1%	0.1%
Wood	0.6%	0.3%	0.3%
Rains	0.5%	0.3%	0.3%
San Augustine	0.5%	0.7%	1.2%
Hardin	0.5%	0.6%	0.1%
Foard	0.5%	0.0%	0.0%
Bexar	0.4%	0.5%	0.5%
Other States	7.7%	6.9%	8.3%
Other	4.6%	5.4%	5.8%
Totals	100.0%	100.0%	100.0%

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Operation/Commodity	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Livestock, except dairy and poultry	\$ 186,495,888	41.5%	\$ 175,623,288	42.4%	\$ 169,513,249	46.5%
Field crops except cash grains	47,787,578	10.6%	46,865,127	11.3%	30,876,670	8.5%
Timber	38,107,392	8.5%	36,679,849	8.8%	30,074,068	8.2%
Rural home loans	24,807,715	5.5%	21,153,738	5.1%	9,427,411	2.6%
Poultry and eggs	23,918,628	5.3%	25,580,305	6.2%	22,753,671	6.2%
Animal specialties	16,257,301	3.6%	16,114,761	3.9%	5,018,086	1.4%
Food and kindred products	16,241,356	3.6%	16,577,562	4.0%	16,479,592	4.5%
Agricultural services	9,595,721	2.1%	8,171,963	2.0%	6,061,467	1.7%
Dairy farms	7,247,708	1.6%	7,585,095	1.8%	7,485,082	2.1%
Wholesale trade - nondurable goods	7,154,146	1.6%	5,158,551	1.2%	837,027	0.2%
Horticultural specialties	4,573,822	1.0%	5,642,444	1.4%	4,437,045	1.2%
Paper and allied products	4,279,532	1.0%	2,909,757	0.7%	2,667,956	0.7%
Communications	2,532,302	0.6%	2,356,226	0.6%	5,253,618	1.4%
Cash grains	2,138,338	0.5%	2,406,855	0.6%	5,068,030	1.4%
Food stores	1,650,000	0.4%	1,314,000	0.3%	4,658,333	1.3%
Fruit and tree nuts	807,125	0.2%	772,491	0.2%	605,641	0.2%
Vegetables and melons	277,233	0.1%	292,044	0.1%	305,876	0.1%
Other	56,016,025	12.5%	38,841,905	9.4%	43,231,713	11.8%
Total	\$ 449,887,810	100.0%	\$ 414,045,961	100.0%	\$ 364,754,535	100.0%

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

Asset Quality:

The following table reflects the credit quality of the Association's loan volume as of December 31:

	2008	2007	2006
Acceptable	92.8%	96.6%	96.2%
Special mention	2.2%	1.0%	2.9%
Substandard	5.0%	2.4%	0.9%
Doubtful	0.0%	0.0%	0.0%
Loss	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following presents information relating to impaired loans as of December 31:

	2008		2007		2006	
	Amount	%	Amount	%	Amount	%
Nonaccrual loans						
Current as to principal and interest	\$ 9,308,849	58.2%	\$ 4,782,770	74.7%	\$ 419,257	48.5%
Past due	5,838,255	36.4%	1,105,080	17.3%	444,318	51.5%
Total nonaccrual loans	<u>15,147,104</u>	<u>94.6%</u>	<u>5,887,850</u>	<u>92.0%</u>	<u>863,575</u>	<u>100.0%</u>
Accrual loans						
90 days or more past due	859,545	5.4%	511,968	8.0%	-	0.0%
Formally restructured	-	0.0%	-	0.0%	-	0.0%
Total impaired accrual loans	<u>859,545</u>	<u>5.4%</u>	<u>511,968</u>	<u>8.0%</u>	<u>-</u>	<u>0.0%</u>
Total impaired loans	<u>\$ 16,006,649</u>	<u>100.0%</u>	<u>\$ 6,399,818</u>	<u>100.0%</u>	<u>\$ 863,575</u>	<u>100.0%</u>

Increase in nonaccrual loans of \$9,259,254 in 2008 is primarily related to five large loans. Two of the large loans are to one borrower for a total of \$1.1 million and are more than 180 days past due. These two loans are in the process of collection with a plan to bring current or pay off in 2009. Another loan for \$4.6 million at December 31, 2008 was placed into nonaccrual when the borrowing entity filed bankruptcy in December 2008. This loan was purchased from another Farm Credit association who is currently working on a restructuring plan with the borrowing entity. The last two large loans for \$3.5 million are to one borrowing entity that has incurred significant operating losses due to the downturn in the beef cattle industry. These loans were 60 days past due at December 31, 2008 and are in the process of collection and anticipated to be paid off in 2009.

Of the \$15,147,104 in nonaccrual loan volume, \$9,308,849 is current as to principal and interest payments at December 31, 2008. The majority of this balance is comprised of three loans totaling \$8,531,193. One of these loans was placed into nonaccrual due to the borrowing entity reporting operating losses, industry stress, and the fact that the borrowing entity filed bankruptcy in 2008. The other two loans are to one entity that has experienced substantial industry stress, past operating losses, and has failed to meet the required financial covenants set out in the loan agreement.

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2008.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2, "Summary of Significant Accounting Policies." The following table presents interest income recognized on impaired loans.

	2008	2007	2006
Interest income recognized on nonaccrual loans	\$ 54,450	\$ 178,965	\$ 29,733
Interest income recognized on impaired accrual loans	59,210	44,674	-
Interest income recognized on impaired loans	<u>\$ 113,660</u>	<u>\$ 223,639</u>	<u>\$ 29,733</u>

A summary of the allowance for loan losses as of December 31 follows:

	2008	2007	2006
Beginning balance	\$ 903,855	\$ 492,061	\$ 536,664
Provision for loan losses	2,966,448	489,842	(14,887)
Loans charged off	(2,020,908)	(78,837)	(29,716)
Recoveries	6,956	789	-
Allowance for loan losses	<u>\$ 1,856,351</u>	<u>\$ 903,855</u>	<u>\$ 492,061</u>

The following table presents information concerning impaired loans as of December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Impaired loans with related allowance	\$ 4,727,568	\$ 3,128,751	\$ 51,473
Impaired loans with no related allowance	11,279,081	3,271,067	812,102
Total impaired loans	<u>\$ 16,006,649</u>	<u>\$ 6,399,818</u>	<u>\$ 863,575</u>
Allowance on impaired loans	<u>\$ 1,469,100</u>	<u>\$ 703,000</u>	<u>\$ 36,500</u>

The following table summarizes impaired loan information for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Average impaired loans	<u>\$ 6,564,931</u>	<u>\$ 1,740,670</u>	<u>\$ 1,487,472</u>

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest income which would have been recognized under the original terms	\$ 823,009	\$ 430,205	\$ 232,293
Less: interest income recognized	(113,660)	(223,639)	(29,733)
Foregone interest income	<u>\$ 709,349</u>	<u>\$ 206,566</u>	<u>\$ 202,560</u>

NOTE 4 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Land and improvements	\$ 351,012	\$ 351,012	\$ 351,011
Building and improvements	1,572,484	1,512,274	1,495,968
Furniture and equipment	278,565	274,021	265,647
Computer equipment and software	124,023	108,181	113,359
Automobiles	254,278	302,968	289,459
	<u>2,580,362</u>	<u>2,548,456</u>	<u>2,515,444</u>
Accumulated depreciation	(824,952)	(779,010)	(730,161)
Total	<u>\$ 1,755,410</u>	<u>\$ 1,769,446</u>	<u>\$ 1,785,283</u>

The Association leases office space in Athens, Nacogdoches and Greenville. Lease expense was \$48,214, \$51,502 and \$75,630 for 2008, 2007 and 2006, respectively. Minimum annual lease payments for the next five years are as follows:

	<u>Operating</u>
2009	\$ 59,616
2010	40,449
2011	26,328
2012	5,259
Thereafter	-
Total	<u>\$ 131,652</u>

NOTE 5 – OTHER PROPERTY OWNED, NET:

Net gain (loss) on other property owned, net consists of the following for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Gain on sale, net	\$ 110,822	\$ 3,101	\$ -
Operating expense, net	(4,957)	(3,645)	-
Net gain (loss) on other property owned	<u>\$ 105,865</u>	<u>\$ (544)</u>	<u>\$ -</u>

NOTE 6 — NOTE PAYABLE TO THE BANK:

The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. The Association's indebtedness to the Bank represents borrowings by the Association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the Association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the Bank's cost of funding the loans the Association has outstanding to its borrowers.

The total amount and the weighted average interest rate of the Association's direct loan from the Bank at December 31, 2008, 2007 and 2006, was \$388,967,769 at 4.22 percent, \$358,436,126 at 5.42 percent and \$312,456,213 at 5.45 percent, respectively.

Under the Act, the Association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2008, 2007 and 2006, the Association's note payable was within the specified limitations. The maximum amount the Association may borrow from the Bank as of December 31, 2008, was \$435,705,781, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of and for the years ended December 31, 2008, 2007 and 2006, the Association was not subject to remedies associated with the covenants in the financing agreement.

NOTE 7 — MEMBERS' EQUITY:

In accordance with the Act and Association's capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. The investment in Class B capital stock (for farm loans) or participation certificates (for rural home and farm-related business loans) is equal to 2 percent of the loan amount, up to a maximum amount of \$1,000. The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the Association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the Board of Directors of the Association may increase the percentage of stock requirement for each borrower up to a maximum of 10 percent of the loan amount. Each owner of Class B capital stock is entitled to a single vote, while participation certificates provide no voting rights to their owners.

Within two years of repayment of a loan, the Association capital bylaws require the conversion of any borrower's outstanding Class B to Class C stock. Class C stock has no voting rights except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of Class C shares is made solely at the discretion of the Association's Board of Directors. At December 31, 2008, 2007 and 2006, the Association had no Class C stock.

All borrower stock is at-risk. As such, losses that result in impairment of capital stock or participation certificates shall be borne on a pro rata basis by all holders of Class B and participation certificates. In the event of liquidation of the Association, capital stock and participation certificates would be utilized as necessary to satisfy any remaining obligations in excess of the amounts realized on the sale or liquidation of assets. Any excess of the amounts realized on the sale or liquidation of assets over the Association's obligations to external parties and to the Bank would be distributed to the Association's stockholders.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the Association, as the board of directors may determine by resolution subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following dividends and patronage distributions were declared and paid in 2008, 2007 and 2006, respectively:

<u>Date Declared</u>	<u>Date Paid</u>	<u>Patronage</u>
December 2008	----	\$ 2,480,000
March 2008	April 2008	\$ 168,281
December 2007	April 2008	\$ 2,863,250
	Total 2008	\$ 3,031,531
December 2006	April 2007	\$ 4,377,520

In 2006, the Board of Directors also declared a distribution of \$2,918,348, as allocated equities to stockholders to be paid at a future date at their discretion. The Association, PCA and FLCA, as applicable, shall have a first lien on all allocated equity accounts owned by any patron. Therefore, when the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association may order any and all surplus account allocations owned by such borrower to be applied on the indebtedness. In 2008 and 2007 the Association applied \$15,301 and \$18,003, respectively, of allocated equities to borrowers' indebtedness that were in default.

The FCA's capital adequacy regulations require the Association to achieve permanent capital and total surplus of at least 7.0 percent and core surplus of at least 3.5 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the ratio requirements can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to stockholders unless prescribed capital standards are met. The Association's permanent capital ratio, core surplus ratio and total surplus ratio at December 31, 2008, were 12.8 percent, 12.2 percent and 12.2 percent, respectively.

The Association has established a capital planning process that provides an objective basis for determining its capital requirements. This planning process incorporates the District's financial performance standards and the income, expense, capital and business goal projections for the Association. The Association has established a permanent capital objective of 12 percent. It is the Association's belief that a capital objective of 12 percent will ensure the Association's future viability, provide for continued growth in both long- and short-term lending, and support a high level of quality service to its stockholders. The Association also plans to continue the payment of patronage to its stockholders on an annual basis based on the Association's financial performance.

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

At December 31, the Association had the following shares of Class B stock and participation certificates outstanding at a par value of \$5 per share:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Class B stock	<u>489,062</u>	484,156	465,522
Participation certificates	<u>47,403</u>	47,019	40,354
Total	<u><u>536,465</u></u>	<u><u>531,175</u></u>	<u><u>505,876</u></u>

NOTE 8 — INCOME TAXES:

The Association had no tax provision or benefit recognized in 2008, 2007 and 2006. The Association carries a deferred tax asset as of December 31, 2008 of \$869,854, which results from the establishment of an allowance for loan losses on the short-term loan portfolio of \$212,871, charitable contributions carryover of \$27,964 and a net operating loss carryforward for Heritage Production Credit, PCA in the amount of \$5,558,189. Net operating losses were \$2,559,349, which was primarily made up of provision for loan loss of \$1,839,908, \$936,405 and \$493,603 for the years ending December 31, 2008, 2007 and 2006, respectively. The Association has recorded a full valuation allowance against the gross deferred tax asset for the years ending December 31, 2008, 2007 and 2006 based on management's estimate that it is more likely than not (over 50 percent probability) that it will not be realized. The Association will continue to evaluate the realizeability of these deferred tax assets and adjust the valuation allowance accordingly.

No deferred income taxes have been provided on accumulated earnings of the FLCA subsidiary, as it is management's intent to permanently maintain this investment in the FLCA subsidiary or to distribute the earnings to the stockholders in a manner that results in no additional tax liability. The Association adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), on January 1, 2007, and determined that interest and penalties would be classified as a component of income taxes. The adoption of FIN 48 did not have a material effect on the Association's financial statements.

NOTE 9 — EMPLOYEE BENEFIT PLANS:

Employee Retirement Plans: Employees of the Association participate in either the defined benefit retirement plan (DB Plan) or the defined contributions plan (DC Plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section G of Note 2, "Summary of Significant Accounting Policies."

Other Postretirement Benefits: In addition to pension benefits, the Association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities. To be eligible for the health and welfare benefits, an employee must have been hired prior to January 1, 2005, completed 10 years of service and be at least age 55. The employee can also qualify at age 50 but must have at least 30 years of service. In accordance with SFAS 106, the Association recognizes the liability for the contractual obligation of these benefits as employees render the services necessary to earn the benefits.

In September 2006, the FASB issued "Employers Accounting for Defined Benefit and other Postretirement Plans" (SFAS No. 158), which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS No. 158 were adopted at December 31, 2007. SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, the System used a September 30 measurement date for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year-end measurement date. The System has applied the second approach, which allows for the use of the measurements determined for the prior year end.

Under this alternative, pension and postretirement benefit income measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 2007 measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As a result, the Association decreased retained earnings \$5,521 net of taxes and increased the pension and other postretirement benefit liabilities by \$5,521.

The following table reflects the benefit obligation, cost and actuarial assumptions for the Association's other postretirement benefits:

Disclosure Information Under FASB Statement 132	2008	2007	2006
Change in accumulated postretirement benefit obligation			
Accumulated postretirement benefit obligation, beginning of year	\$ 592,270	\$ 791,587	\$ 747,857
Service cost	23,818	31,223	39,305
Interest cost	47,284	46,869	39,007
Plan participants' contributions	9,625	2,161	867
Plan amendments	-	-	(8,932)
Special termination benefits	-	-	-
Actuarial loss (gain)	42,838	(254,384)	(7,521)
Benefits paid	(33,056)	(25,186)	(18,996)
Accumulated postretirement benefit obligation, end of year	\$ 682,779	\$ 592,270	\$ 791,587
Change in plan assets			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Actual return on plan assets	-	-	-
Company contributions	23,431	23,025	18,129
Plan participants' contributions	9,625	2,161	867
Benefits paid	(33,056)	(25,186)	(18,996)
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Reconciliation of funded status			
Funded status of the plan	\$ (682,779)	\$ (592,270)	\$ (791,587)
Unrecognized prior service cost	-	-	(336,756)
Unrecognized net loss	-	-	9,533
Contributions between measurement date and fiscal year-end	-	4,290	4,370
Net postretirement liability at end of year	\$ (682,779)	\$ (587,980)	\$ (1,114,440)
Amounts recognized in statement of financial position			
Other liabilities	(682,779)	(587,980)	-
Total	\$ (682,779)	\$ (587,980)	\$ -
Amounts recognized in accumulated other comprehensive income			
Net actuarial gain	\$ (202,901)	\$ (245,332)	\$ -
Prior service credit	(254,334)	(298,243)	-
Total	\$ (457,235)	\$ (543,575)	\$ -
Additional information			
(Increase) decrease in liability included in other comprehensive income	\$ 86,339	\$ (543,575)	\$ -
Weighted-average assumptions used to determine obligations at year-end			
Measurement date	12/31/2008	9/30/2007	9/30/2006
Discount rate	6.30%	6.50%	6.00%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	8.5%/6.5%	8.5%/6.5%	9.0%/6.75%
Health care cost trend rate assumed for next year - Rx	12.00%	12.00%	13.00%
Ultimate health care cost trend rate	5.00%	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2015	2016	2016

Disclosure Information Under FASB Statement 132

	2008	2007	2006
Service cost	\$ 19,054	\$ 31,223	\$ 39,305
Interest cost	37,827	46,869	39,007
Expected return on plan assets	-	-	-
Amortization of:			
Unrecognized net transition obligation (asset)	-	-	-
Unrecognized prior service cost	(35,128)	(38,513)	(37,956)
Unrecognized net loss (gain)	326	481	633
Net postretirement benefit cost	\$ 22,079	\$ 40,060	\$ 40,989
Adjustment to retained earnings for 2008 due to change in measurement date	\$ 5,521	\$ -	\$ -
FAS88 accounting for settlements/curtailments/special termination benefits	\$ -	\$ -	\$ -
Other changes in plan assets and projected benefit obligation recognized in other comprehensive income			
Net actuarial loss (gain)	\$ 42,838	\$ -	\$ -
Amortization of net actuarial loss (gain)	(409)	-	-
FAS88 recognition of loss (gain)	-	-	-
Prior service cost (credit)	-	-	-
Amortization of prior service cost	43,910	-	-
FAS88 recognition of prior service cost	-	-	-
Amortization of transition liability (asset)	-	-	-
Total recognized in other comprehensive income	\$ 86,339	\$ -	\$ -
AOCI amounts expected to be amortized into expense in 2009			
Unrecognized net transition obligation (asset)	\$ -	\$ -	\$ -
Unrecognized prior service cost	(34,565)	(35,128)	-
Unrecognized net loss (gain)	(9,987)	326	-
Total	\$ (44,552)	\$ (34,802)	\$ -
Weighted-average assumptions used to determine benefit cost			
Measurement date	9/30/2007	9/30/2006	9/30/2005
Discount rate	6.50%	6.50%	6.00%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	9.0%/6.75%	8.5%/6.5%	9.0%/6.75%
Health care cost trend rate assumed for next year - Rx	13.00%	12.00%	13.00%
Ultimate health care cost trend rate	4.75%	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2016	2016	2016

Expected future cash flows

Expected benefit payments (net of employee contributions)

Fiscal 2009	\$ 31,042
Fiscal 2010	40,605
Fiscal 2011	51,407
Fiscal 2012	49,966
Fiscal 2013	53,220
Fiscal 2014–2018	216,388

Expected contributions

Fiscal 2009	\$ 31,042
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NOTE 10 — RELATED PARTY TRANSACTIONS:

Directors of the Association, except for any director-elected directors, are required to be borrowers/stockholders of the Association. Also, in the ordinary course of business, the Association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons for the Association amounted to \$3,564,014, \$3,339,588 and \$2,404,649 at December 31, 2008, 2007 and 2006, respectively. During 2008, \$1,801,650 of new loans were made and repayments totaled \$1,577,225. In the opinion of management, no such loans outstanding at December 31, 2008, 2007 and 2006 involved more than a normal risk of collectibility.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems, accounting services and allocations of expenses incurred by the Bank passed through to the associations such as FCSIC expenses. The Bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$894,060, \$863,594 and \$761,223 in 2008, 2007 and 2006, respectively.

The Association received patronage payments from the Bank totaling \$2,110,225, \$1,952,695 and \$1,767,111 during 2008, 2007 and 2006, respectively.

NOTE 11 — COMMITMENTS AND CONTINGENCIES:

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

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount 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 contract. Commitments to extend credit to borrowers at December 31, 2008, totaled \$32,640,552. This amount represents unfunded commitments on revolving lines of credit and other loans with provisions allowing the borrower to pay down the balance and draw advances up to the credit limit. Also included in this amount are written commitments to extend credit to a borrower, where the commitment had not been funded as of December 31, 2008.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financing obligations and generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2008, standby letters of credit outstanding totaled \$1,386,389. No liability has been recorded by the Association associated with these letters of credit because the fair value of these obligations at December 31, 2008 is based on the fees for the unexpired period remaining, which are negligible.

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

NOTE 12 — DISCLOSURE ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS:

The following table presents the carrying amounts and estimated fair values of the Association's financial instruments at December 31, 2008, 2007 and 2006. Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, discount rates, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments as of December 31 follow:

	2008		2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets						
Cash	\$ 430,025	\$ 430,025	\$ 721,070	\$ 721,070	\$ 361,562	\$ 361,562
Loans, net	448,031,459	464,926,581	413,142,106	413,654,312	364,262,474	362,961,507
Financial liabilities						
Note payable to the Bank	388,967,769	402,652,567	358,436,126	358,823,130	312,546,213	311,429,952

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

A. Cash:

The carrying value is a reasonable estimate of fair value.

B. Loans:

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

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

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

The carrying value of accrued interest approximates its fair value.

C. Investment in the Bank:

Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 2, "Summary of Significant Accounting Policies," the investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying consolidated balance sheet. The Association owns 3.3 percent of the equity of the Bank as of December 31, 2008. As of that date, the Bank's assets totaled \$14.8 billion and members' equity totaled \$744.5 million. The Bank's earnings were \$76.7 million during 2008.

D. Note Payable to the Bank:

The note payable to the Bank is not regularly traded; thus, quoted market prices are not available. Fair value of this instrument is discounted based on the Association's and Bank's loan rates as well as on management estimates. For the purposes of this estimate it is assumed that the cash flow on the note is equal to the principal payments on the Association's loan receivables plus accrued interest on the note payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures. Management has no basis to determine whether the fair values would be indicative of the value negotiated in an actual sale.

E. Commitments to extend credit:

The Association does not normally assess fees on its commitments to extend credit; hence, there is no fair value to be assigned to these commitments until they are funded.

NOTE 13 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED):

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2008				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,013	\$ 3,010	\$ 3,044	\$ 2,903	\$ 11,970
Provision for loan losses	-	(1,007)	(1,614)	(345)	(2,966)
Noninterest expense, net	(407)	(548)	(1,044)	(387)	(2,386)
Net income	\$ 2,606	\$ 1,455	\$ 386	\$ 2,171	\$ 6,618

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,938	\$ 2,888	\$ 2,986	\$ 3,042	\$ 11,854
Reversal of (provision for) loan losses	55	-	(44)	(501)	(490)
Noninterest expense, net	(585)	(632)	(392)	(262)	(1,871)
Net income	\$ 2,408	\$ 2,256	\$ 2,550	\$ 2,279	\$ 9,493

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,389	\$ 2,472	\$ 2,540	\$ 2,840	\$ 10,241
(Provision for) reversal of loan losses	(9)	4	(18)	38	15
Noninterest expense, net	(621)	(257)	(304)	(606)	(1,788)
Net income	\$ 1,759	\$ 2,219	\$ 2,218	\$ 2,272	\$ 8,468

DISCLOSURES REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

DESCRIPTION OF BUSINESS

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

The descriptions of significant developments that had or could have a material impact on earnings or interest rates to borrowers and acquisitions or dispositions of material assets, if any, required to be disclosed in this section are incorporated herein by reference from "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

DESCRIPTION OF PROPERTY

The Heritage Land Bank, ACA (Association) serves its 16-county territory through its main administrative and lending office at 4608 Kinsey Drive, in Tyler, Texas. There are six branch lending offices located throughout the territory. The Association owns the office buildings in Tyler, McKinney and Palestine free of debt. The Association leases the office buildings in Nacogdoches, Athens, and Greenville.

LEGAL PROCEEDINGS

In the ordinary course of business, the Association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the Association.

DESCRIPTION OF CAPITAL STRUCTURE

The information required to be disclosed in this section is incorporated herein by reference from Note 7 to the consolidated financial statements, "Members' Equity," included in this annual report.

DESCRIPTION OF LIABILITIES

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Note 11 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report.

RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS

The Association's financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (Bank), as discussed in Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report. The financial condition and results of operations of the Bank may materially affect the stockholders' investment in the Association.

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 78720-2590 or calling (512) 483-9204. Copies of the District's annual and quarterly stockholder reports can also be requested by e-mailing fcf@farmcreditbank.com. The District's annual and quarterly stockholder reports are also available on its web site at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Heritage Land Bank, ACA, 4608 Kinsey Drive, Suite 100, Tyler, Texas 75703 or calling 903-534-4975. Copies of the Association's quarterly stockholder reports can also be requested by visiting the Association's web site at www.heritagelandbank.com. The Association's annual stockholder report is available on its Web site 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2008, required to be disclosed, is incorporated herein by reference to the “Five-Year Summary of Selected Combined Financial Data” included in this annual report to stockholders.

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

“Management’s Discussion and Analysis,” which precedes the combined financial statements in this annual report, is incorporated herein by reference.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 3, 2009, and the report of management in this annual report to stockholders, are incorporated herein by reference.

RELATIONSHIP WITH INDEPENDENT AUDITOR

No change in auditors has taken place since the last annual report to stockholders and no disagreements with auditors has occurred that the Association is required to report to the Farm Credit Administration under part 621 of the FCA regulations governing this disclosure. Fees paid for audit services to the independent auditors were \$32,450, \$31,998 and \$32,037 in 2008, 2007 and 2006, respectively. Fees paid for tax services rendered by the independent auditors were \$4,500, \$5,000 and \$5,300 for 2008, 2007 and 2006 respectively. No other services were rendered by the independent auditors during these years.

DIRECTORS AND SENIOR OFFICERS

The Association’s member-elected and director-elected board of directors and senior officers are as follows:

<u>NAME</u>	<u>POSITION</u>	<u>DATE ELECTED/ EMPLOYED</u>	<u>TERM EXPIRES</u>
Kevin Sampson	Chairman	2006	2009
Jack S. Pullen	Vice Chairman	1982	2009
Jerry E. Nelson	Director-Elected	2007	2009
Bill Ashworth	Director	1991	2011
Walter H. Baty, Sr.	Director	2006	2009
George Hodges	Director	2007	2010
Keith Nicholas	Director	2007	2010
David Alders	Director	2008	2011
Stephen R. Ogletree	CEO	2006	-
Jenny Sloan	Senior Vice President/CFO	1999	-
Robert A. Echols	Senior Vice President/CCO	1973	-
Mike Overcast	Senior Vice President	2003	-

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

Kevin Sampson, age 40, is the chief mechanical engineer for M.P. Industries, Inc. He runs a cow-calf operation in Smith County. Additionally, he produces hay, forage and timber. Mr. Sampson is a director of the Smith County Farm Bureau. He has held offices of president and vice president of the county Farm Bureau Board and has served on the resolutions committee of the Texas Farm Bureau.

Jack S. Pullen, age 61, is a Texas A&M graduate and owns a cow-calf operation in Rockwall County specializing in breeding of club calves. Mr. Pullen is employed as a right-of-way agent for the Texas Department of Transportation. He is president of RCH Water Corporation, past president of Rockwall Youth Fair, city councilman for McLendon/Chisholm, member of Rockwall Lions Club, charter member of the Rockwall County A&M Club, former director of the Texas Hereford Association and a member of First Presbyterian Church of Rockwall.

Jerry E. Nelson, age 67, owns land in Cass County where he enjoys hunting. He is a CPA and owner of Jerry Nelson & Associates in Tyler. He is a graduate of the University of North Texas and is a member of the Texas Society of CPA's and the American Institute of Certified Public Accountants. He currently serves on the board of the East Texas Food Bank. Mr. Nelson holds the position of director-elected board member for Heritage Land Bank. Jerry Nelson and his wife, Shari, have two children and attend Grace Community Church in Tyler.

Bill Ashworth, age 68, runs a stocker calf and cow-calf operation in Hunt County and raises high quality hay for the public. He is a retired developer and still constructs custom, single-family homes on a limited basis. He serves as a director on the board of Hickory Creek Special Utility District, a committee member of the board of Celeste ISD's facilities committee, a committee member of the building committee of the First Baptist Church of Celeste and is a charter member of the Celeste Lions Club. Mr. Ashworth is also a member of the Independent Cattlemen's Association of Texas.

Walter H. Baty, Sr., age 75, is a retired educator, having served 30 years as teacher, coach and administrator in the Shelbyville ISD. He is the owner of the 3-B Ranch, raising Brangus cattle and is a Tyson Poultry producer. Mr. Baty is a community leader, a member of Ephesus Baptist Church, where he teaches the Adult Men's Class, a member of Sam Houston Lodge #32, a Gideon, and a member and past director of Shelby County Farm Bureau. He also serves on the Shelby County Water Board.

George Hodges, age 58, owns and operates a cow-calf operation in Anderson County. Mr. Hodges is also a part owner of a family grain farm in Illinois. His past experience includes 28 plus years working for the Farm Credit System. Mr. Hodges was a commissioned examiner with the Farm Credit Administration and vice president with the Farm Credit Bank of Texas. He retired in January 2006 after seven years as senior vice president and branch manager for Heritage Land Bank. During his career, Mr. Hodges held numerous chairmanship and leadership positions while working for the Farm Credit System.

Keith Nicholas, age 66, owns and operates a 640-acre cow-calf operation in northern Hunt County, located between Greenville and Commerce. He is a retired U.S. Air Force senior master sergeant and was a systems engineer/flight test director with E-Systems in Greenville. He is a past director of the Hickory Creek Special Utility District. Mr. Nicholas is a member of the Texas and Southwestern Cattle Raisers Association, the American Legion, the National Rifle Association and a life member of the Veterans of Foreign Wars and Air Force Association.

David Alders, age 47, owns and operates Carrizo Creek Corporation, a poultry-based production business. Mr. Alders is a charter member and current vice president of the board of Texas' Office of Rural Community Affairs. He serves on the boards of the Pineywoods Groundwater Conservation District, Nacogdoches Economic Development Corporation, Nacogdoches County Chamber of Commerce, Heartbeat Pregnancy Center, and Regents Academy. He also serves on the Executive Committees of the East Texas Regional Water Planning Group, the Nacogdoches County Farm Bureau, and the Texas Forest County Partnership. He is past chairman of the Texas Farm Bureau Young Farmer and Rancher Committee, the TFB and AFBF Poultry Advisory Committees, as well as the Texas Broiler Council. He owns a 50 percent interest in Principatus Properties, LLC, a real estate investment business, is part owner of Regenero Associates, LLC, owner of a retail business, Sure Green, Inc., chemical lawn care business, and Dagwood Timber, LP, a real estate investment partnership. Mr. Alders serves as a director on each of these business interests.

Stephen R. Ogletree, age 57, CEO, was employed by the Association in November 2006. He had served as CEO of another Farm Credit association since 1985 before coming to Heritage. He has worked in the Farm Credit System for over 34 years. He currently serves on the board of directors for the East Texas State Fair.

Jenny Sloan, age 39, senior vice president/CFO, has been employed by the Association since June 1999. Mrs. Sloan, a certified public accountant, has over 15 years of experience in accounting and auditing. She currently serves as a member on the board of Junior League of Tyler, Junior Achievement of Tyler and the Children's Advocacy Center of Smith County.

Robert A. Echols, age 59, senior vice president/CCO, has been employed by the Association since July 1973.

Mike Overcast, age 61, senior vice president/commercial lending, has been employed by the Association since March 2003. Mr. Overcast was hired as branch manager of the McKinney branch office and was promoted to senior vice president in March 2006. He served as president of the Dallas Ag Club during 2007 and is currently serving on the Board of Directors.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors were compensated for their service to the Association in the form of an honorarium at the rate per day of \$600 for stockholder-elected director, \$700 for chairman and \$1,000 for director-elected director for director meetings and \$400 for committee meetings, approved special meetings and training. In addition, directors are reimbursed for certain expenses incurred while representing the Association in an official capacity. Mileage for attending official meetings during 2008 was paid at the IRS-approved rate. A copy of the travel policy is available to stockholders of the Association upon request.

Director	Number of Days Served Associated With		Total Compensation in 2008
	Board Meetings	Other Official Activities	
Kevin Sampson	15	12	\$ 13,650
Jack S. Pullen	15	17	\$ 14,950
Jerry Nelson	14	11	\$ 17,550
Bill Ashworth	15	13	\$ 13,350
Walter H. Baty, Sr.	14	17	\$ 14,750
George Hodges	15	19	\$ 15,950
Keith Nicholas	15	12	\$ 13,350
David Alders	3	3	\$ 3,000
Horace McQueen	12	9	\$ 12,050
			\$ 118,600

The aggregate compensation paid to directors in 2008, 2007 and 2006 was \$118,600, \$89,100 and \$104,850, respectively. Additional detail regarding director compensation paid for committee service (which is included in the table above as other official activities) is as follows:

Director	Audit Committee
Kevin Sampson	\$ 0
Jack S. Pullen	1,600
Jerry Nelson	1,600
Bill Ashworth	0
Walter H. Baty, Sr.	1,600
George Hodges	2,000
Keith Nicholas	0
David Alders	400
Horace McQueen	0
	\$ 7,200

The Board's other committees, including the Compensation Committee, held meetings in 2008; however, those meetings fell on the same days as board meetings. The Board of Directors elected not to get paid committee meeting honorariums if the committee meeting was held on the same day as a board meeting.

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$60,481, \$46,102 and \$51,052 in 2008, 2007 and 2006, respectively.

Name of Individual or Group	Year	Salary	Bonus	Deferred Prerequisites	Other	Total
Chief Executive Officer:						
Stephen R. Ogletree	2008	\$208,657	\$62,400	--	--	\$271,057
(November 2006 to date)	2007	194,590	55,500	--	--	250,090
	2006	23,125	--	--	--	23,125
Allen Buckner	2006	\$138,130	--	--	\$35,104	\$173,234
(January 2006 to October 2006)						
Five highest paid officers	2008	\$480,351	\$113,436	--	--	\$593,787
	2007	446,870	126,790	--	--	573,660
	2006	410,512	89,918	--	--	500,430

In 2008, 2007 and 2006 there were three senior officers and two branch managers included in the five highest paid officers of the Association. No noncash or deferred compensation in excess of \$5,000 was given to any one senior officer in 2008, 2007 and 2006. Other compensation paid in 2006 to the chief executive officer, Allen Buckner, represents vacation pay. Disclosure of information on the total compensation paid during the last fiscal year to any senior officer or to any other officer included in the aggregate is available and will be disclosed to shareholders of the institution upon request.

The CEO and senior officers of the Association are paid a salary and are eligible for a yearly bonus based on the achievement of annual goals set by the Board of Directors. All full-time employees are also eligible to participate in the Bonus Program. The effective date of the bonus program shall be the fiscal year of the Association. Payouts will occur no later than February of each year after confirmation and verification of results of the prior year by the board of directors. Branch office employees' bonuses will be based on performance criteria related to their individual branches' profitability. The Association considered profitability to include loan pricing, collection of fee income, new business, and credit quality of the portfolio.

Corporate office employees' bonuses are to reward those who support the lending staff and administration of the Association. Therefore, the corporate office bonuses will be based on an average percentage of all branch office bonuses. Corporate office employees include accounting, loan processing, credit analysts, technical support, the Chief Financial Officer and the Chief Credit Officer. The CEO is excluded and any bonus compensation will be determined separately by the Board of Directors.

As of December 31, 2008, there were no other compensation plans for senior officers.

Employees assigned Association automobiles reimburse the Association for personal miles at a board-established rate. Employees who use their personal automobiles for business purposes were reimbursed during 2008 at the IRS-approved rate.

TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS

The Association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 10 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS

Heritage Land Bank, ACA (the Association) recognizes that adequate capital resources are a significant obstacle facing youth, beginning and small (YBS) farmers and ranchers. The Association is aware that the future success of America's agricultural and/or aquatic production is dependent on adding and retaining a new generation of producers who are well trained in production and marketing and have access to a steady source of financing. Since lending support to YBS operators is of utmost importance, the Association has designed a program with special underwriting criteria along with other enhancements. The Association continues to actively support other programs, events, scholarships, and educational activities that benefit young individuals who will become the next generation of agricultural providers.

The following are definitions for “young,” “beginning,” and “small” farmers and ranchers used by the Association:

Young Farmer and Rancher – A farmer, rancher or producer or harvester or aquatic products who is age 35 or younger as of the date the loan was originally made.

Beginning Farmer and Rancher – A farmer, rancher or producer of aquatic products who has 10 years or less of experience at farming, ranching or production or harvesting aquatic products as of the date the loan was originally made.

Small Farmer and Rancher – A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250,000 in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The Association provides quarterly and annual reports measuring achievement with respect to the Association’s performance against YBS goals and the demographics of the territory it serves using USDA AgCensus data. When compared to the 2002 USDA-NASS AgCensus data for the Association’s 16 chartered counties it serves, the Association has improved the penetration in all market segments except for young farmers from 2007 to 2008 as shown below:

	2002 USDA AgCensus	Heritage Land Bank, ACA			
		2007	% of Market Segment	2008	% of Market Segment
Total Farms	20,753	1,773	8.5%	1,818	8.8%
Young Farmers	1,035	390	37.7%	407	39.3%
Beginning Farmers	7,844	1,265	16.1%	1,295	16.5%
Small Farmers	20,101	1,715	8.5%	1,764	8.8%

The Association’s YBS loan activity for 2008 is reflected in the following table:

YBS Farmers and Ranchers					
	Number	Percent of Portfolio	Dollars		Percent of Portfolio
			(\$ in Thousands)		
Loans and Commitments Outstanding at December 31, 2008:					
Young	662	19.77%	\$	60,070	12.50%
Beginning	2,014	60.15%		280,183	58.30%
Small	2,756	82.32%		372,039	77.43%
Gross New Loans and Commitments Made During 2008:					
Young	127	19.94%	\$	12,387	11.32%
Beginning	368	57.77%		68,367	62.51%
Small	520	81.63%		90,616	82.87%

Note: Young, Beginning and Small farmer and rancher categories are not mutually exclusive, and certain farmers and ranchers may be classified in more than one category in the table above.

In 2008, the Association targeted closing 650 new loans with 5 percent to young farmers, 35 percent to beginning farmers, and 70 percent to small farmers. At December 31, 2008, the Association closed 637 new loans with 20 percent to young farmers, 58 percent to beginning farmers, and 82 percent to small farmers, far exceeding the 2008 goals. The Association participated in many outreach activities in 2008 including youth livestock shows, hay shows, County Extension programs, local Farm Day, 4-H and FFA events, and Chamber activities. The Association is also a proud sponsor of the Farm Credit Bank of Texas District YBS program which sponsors many events throughout its territory.