



AAFMAA
2006
Annual Report

Our Mission is to be the premier provider of insurance and survivor services to the Army and Air Force communities.

AAFMAA Board of Directors

(as of 31 December 2006)

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Chairman of the Board



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GEN, USA, Retired
Vice Chairman of the Board
Chairman, Finance Committee



DENNIS J. REIMER
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President and Treasurer

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(Board members are listed in order of longevity on the Board.)

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LARRY O. SPENCER
Brig Gen, USAF

Front Cover: Air Force Memorial. The Air Force Memorial spires soar toward the night sky, the lights of nearby Washington D.C. glowing in the background. Designed by the late James Ingo Freed, the memorial pays tribute to and honors the patriotic men and women of the U.S. Air Force and its predecessor organizations. (U.S. Air Force photo/Tech. Sgt. Christopher J. Matthews)

AAFMAA members belong to a special organization, wholly dedicated to providing stability and support to members of the Army and Air Force communities. AAFMAA's low cost life insurance provides valuable financial protection to members and their families. AAFMAA's exclusive Survivor Assistance Services guide surviving family members through some of the administrative processes that occur after a death. Especially in the current environment of war, AAFMAA's services have never been more significant. As an AAFMAA member since 1960, a Board Member since 1992 and Chairman of the Board since December of 2006, it is an honor to address the membership in the 2006 Annual Report.

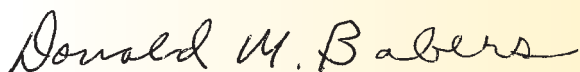
With membership comprised solely of military service members, AAFMAA understands the importance of proper insurance coverage for members and their families. Our Association offers products that recognize the distinct insurance needs of you and your family. AAFMAA policies have no war clauses, no aviation clauses or surcharges and no terrorist clauses. At any time before, during or after deployment, members may apply for new policies. Assignment to a combat zone or other deployment will not negatively affect an application for AAFMAA insurance. Scores of our members have been issued policies on their way to deployment and/or after they were already deployed. As further recognition of our members' unique insurance needs, in 2006 AAFMAA began offering "Jet Issues" on active duty spouse policies of \$100,000 or less! (We had already been providing "Jet Issues" to active duty service members under age 40 for many years!) This means that a spouse (under age 40) of an active duty AAFMAA member can apply for a Level Term I or Value-Added Whole Life policy of \$100,000 or less without having to go through additional medical underwriting after submitting their application. What a great way to make the process easy and simple!

Hand-in-hand with the insurance protection is our commitment to take care of your family when you are gone. AAFMAA's hallmark Survivor Assistance Services take care of your surviving family, at no additional cost. It's included with your membership. We make sure that your surviving family members can always obtain answers to questions on getting and maintaining the benefits you earned for them.

AAFMAA exists to serve the Army and Air Force communities with insurance coverage tailored to your needs and Survivor Assistance Services to assist your survivors. AAFMAA members place themselves in harm's way to protect our nation; AAFMAA is proud to protect them and their families. The successes of 2006 further illustrate the important role that AAFMAA plays in the lives of military families. In 2006 our membership, insurance in force and policies in force reached all-time highs. Please see the Message from the President and Treasurer for more on AAFMAA's financial achievements.

It is my honor to serve the Membership now as Chairman of the Board. I pledge to do my very best for the benefit of all members and their families.

Respectfully,



DONALD M. BABERS
Lieutenant General, USA, Retired

Message from the Chairman



With membership comprised solely of military service members, AAFMAA understands the importance of proper insurance coverage for members and their families. Our Association offers products that recognize the distinct insurance needs of you and your family. ■

AAFMAA's legacy of support, commitment, deeds, and service has brought peace of mind and security during these difficult and uncertain times to the members of our Armed Forces and their families.

Message to the Army and Air Force Mutual Aid Association

UNITED STATES AIR FORCE

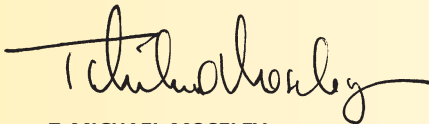
19 February 2007

Since 1879, the Army and Air Force Mutual Aid Association has been an invaluable resource for our military in times of personal need. Congratulations on 128 years of excellence.

A central concern of the Air Force leadership is the financial and emotional welfare of our military members and their families. The Army and Air Force Mutual Aid Association's legacy of support, commitment, deeds and service has brought peace of mind and security during these difficult and uncertain times to the members of our Armed Forces and their families.

Your Association has earned our deepest respect and gratitude for its important work and for its countless efforts on behalf of our men and women in uniform. Thank you for the work that you perform and best wishes for continued success.

Sincerely,



T. MICHAEL MOSELEY
General, United States Air Force

UNITED STATES ARMY

19 February 2007

Congratulations on the 128 years of dedicated assistance and support the Army and Air Force Mutual Aid Association has provided to the Soldiers and family members of America's Army.

Today, we remain a Nation at war. Our men and women in uniform are fighting courageously in defense of America's interests. In these challenging times, the connection between readiness and Soldier well-being is especially clear. Since 1879, the Army and Air Force Mutual Aid Association has played an important role in making its services available in times of need. Our Soldiers can face the hazards of duty and separation from loved ones knowing that, if needed, their family members will receive competent and compassionate assistance and support from your organization.

Thank you and best wishes for continued success.

Sincerely,



PETER J. SCHOOMAKER
General, United States Army

Dear Fellow AAFMAA Members:

In 2006, AAFMAA further strengthened its ability to meet its mission “to be the premier provider of insurance and survivor services to the Army and Air Force communities.” During the year we achieved strong growth in insurance in force, policies, lives insured and members. AAFMAA sold over \$3.3 billion of insurance. Total insurance in force at year end exceeded \$14.3 billion (an 18.9% increase from 2005). Policies in force increased to a new record of 104,359 and total lives insured reached an all-time high of 81,207. Membership grew by a net 2,763, a 3.8% increase.

Equally as important as healthy sales and controlled costs are strong investment returns. In 2006, total admitted assets grew to over \$908 million, an 8.9% increase. AAFMAA’s commercial real estate loan program exemplifies our quantitative investment philosophy and long term perspective. Over a period of 13 years, AAFMAA transformed defaulted loans and dilapidated holdings into a portfolio of Northern Virginia gems: the Starco Properties. On 1 December 2006, AAFMAA sold the Starco portfolio, resulting in a record gain of over \$28 million — the largest gain from a single transaction in the Association’s history. The Net Yield on Assets for 2006 was 5.4%. The method used to calculate the Net Yield on Assets ignores capital gains such as were achieved on the sale of Starco. If the gains from the sale of Starco were included, a comparable Net Yield would approximate 8.6%.

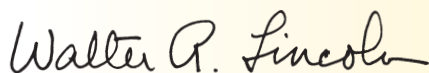
Maintaining strong sales, along with controlling costs and carefully managing our investments, strengthens AAFMAA’s financial foundation. Our success in these three key areas allowed AAFMAA to return over **\$51 million** to our members, policy holders, and their beneficiaries in 2006, including:

- ★ \$13 million in cash value increases,
- ★ \$35 million in death benefit claims,
- ★ \$1 million in term insurance partial premium refunds, and
- ★ \$2 million in Living Services and Survivor Assistance Services.

The outstanding achievements of 2006 enabled AAFMAA to increase our already impressive crediting rate to 7.1% for 2007 on Value-Added Whole Life insurance.

By selling more, controlling costs and investing wisely, AAFMAA expanded and grew even stronger. Your support of AAFMAA is vital. Thank you for your membership and continued trust.

Sincerely,



WALTER R. LINCOLN, CFP®
MAJ, USA, Retired
President and Treasurer

Message from the President and Treasurer



*Maintaining
strong sales, along
with controlling costs
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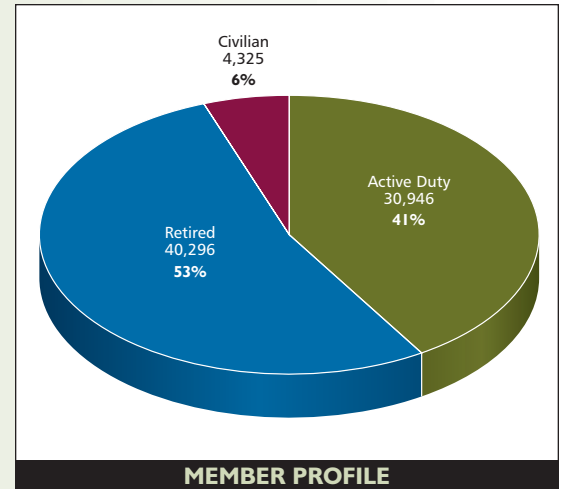
AAFMAA Overview 2006

COMPARATIVE HIGHLIGHTS

	YEAR ENDED 31 DECEMBER	
	2006	2005
Insurance in force (\$ millions)	\$14,361	\$12,080
Total reserves (\$ millions)	\$871	\$811
Number of members	75,567	72,804
Number of member deaths	884	833
Death benefits paid (\$ millions)	\$35.3	\$38.6
Net Yield on Assets	5.4%	6.4%

STATEMENT OF THE ASSOCIATION ACTUARY A.C. EDDY, INC., NORCROSS, GA

In my opinion the reserves of the Association are necessary and sufficient to provide for liabilities to its membership and will achieve the objective of distributing the Association's assets to members and/or their beneficiaries in an equitable manner.

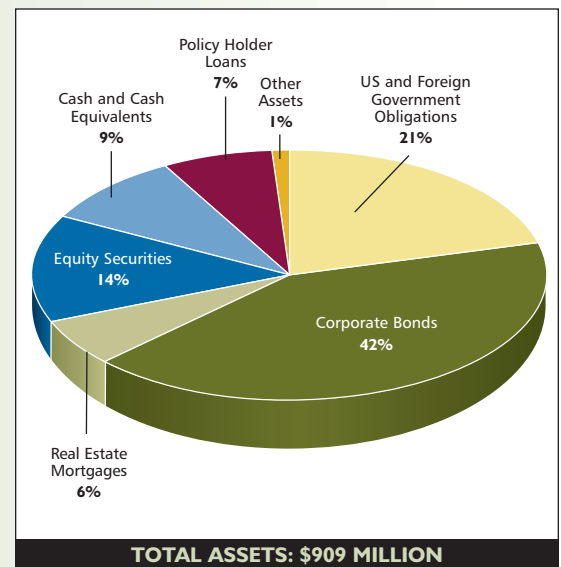


2006 Assets

SUMMARY OF ASSETS

SECURITIES	YEAR ENDED 31 DECEMBER	
	AMORTIZED VALUE	MARKET VALUE
U.S. and Foreign Government Obligations	\$186,773,968	\$186,013,420
Corporate Bonds	381,898,915	398,184,794
Real Estate Mortgages	55,812,040	55,812,040
Equity Securities*	130,522,277	130,522,277
Cash and Cash Equivalents	79,041,256	79,040,572
Accrued Investment Income	<u>9,459,598</u>	<u>9,459,598</u>
Total Securities	843,508,054	859,032,701
Policy Holder Loans	63,464,416	63,464,416
Property & Equipment Net of Accumulated Depreciation	458,964	458,964
Other Assets	<u>1,219,344</u>	<u>1,219,344</u>
Total Assets	<u>\$908,650,778</u>	<u>\$924,175,425</u>

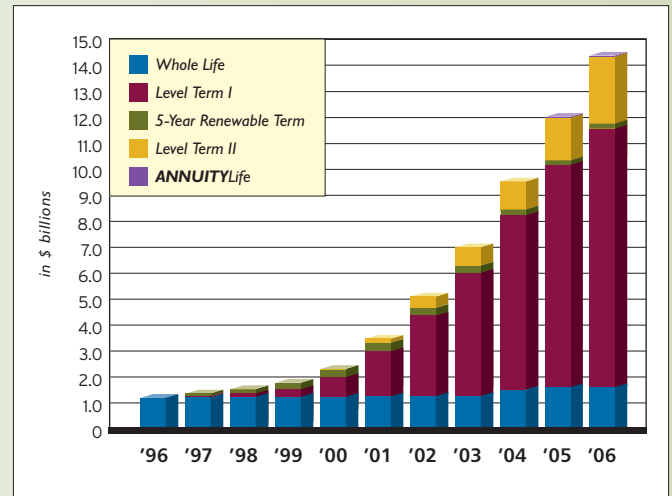
*Equity Securities are valued at market.



Insurance in Force

Insurance in force, beginning of year	\$12,080,146,187
Insurance sold	.\$3,313,699,701
Death benefit growth	.\$7,889,463
Death benefits incurred	.\$(35,307,727)
Other terminations	.\$(1,005,590,707)

Insurance in force, end of year \$14,360,836,917

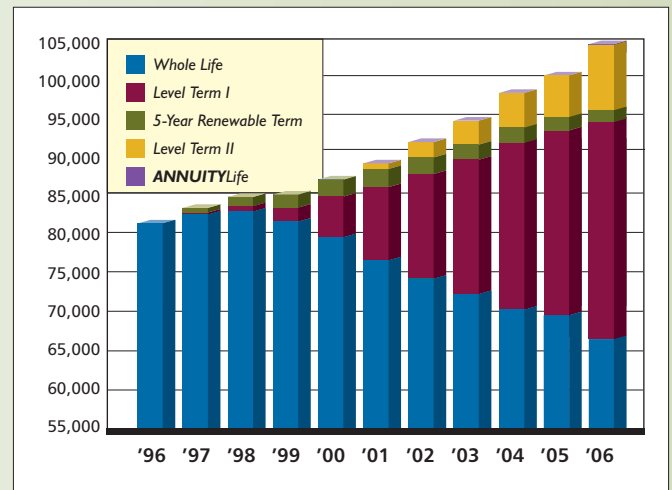


Policies in Force

Policies in force, beginning of year	100,902
New policies issued	8,660
Policies matured by death	.(1,283)
Other policy net terminations	.(3,920)

Policies in force, end of year104,359

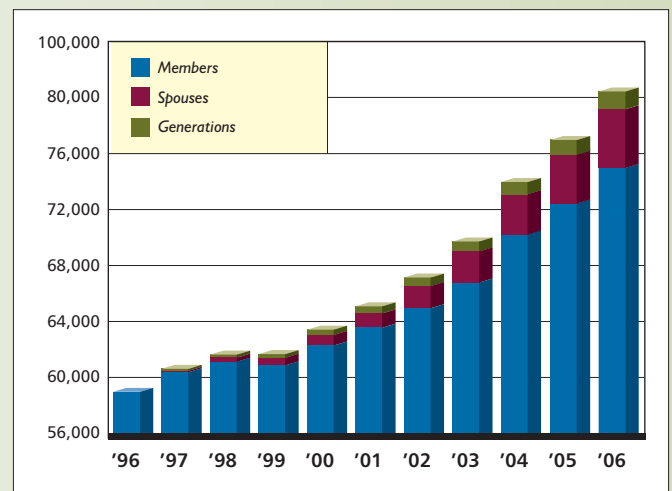
Note: Beginning balance includes 226 Service Only (SO) policies and ending balance includes 208 SO policies.



Lives Insured

Members, beginning of year	72,804
Gains	5,656
Losses	.(2,893)
Members, end of year	75,567
Spouses and Generations, beginning of year	4,695
Gains	1,090
Losses	.(145)
Spouses and Generations, end of year	5,640

Lives insured, end of year81,207



Statement of Assets, Liabilities and Reserves

STATUTORY BASIS

For the year ended 31 December 2006

ASSETS

BONDS

U.S. and Foreign Government Obligations	\$ 186,773,968	
Corporate Bonds	<u>381,898,915</u>	
Total Bonds		\$ 568,672,883

REAL ESTATE MORTGAGES		55,812,040
EQUITY SECURITIES		130,522,277
POLICY HOLDER LOANS		63,464,416
CASH AND CASH EQUIVALENTS		79,041,256
ACCRUED INVESTMENT INCOME		9,459,598
PROPERTY AND EQUIPMENT, AT COST (less accumulated depreciation of \$1,039,659)		458,964
OTHER		<u>1,219,344</u>
TOTAL ASSETS		<u>\$ 908,650,778</u>

LIABILITIES AND RESERVES

LIABILITIES

Death Benefits Payable	\$ 10,985,133	
Accounts Payable	20,444,460	
Deferred Revenue	1,438,393	
Settlement Options Payable	4,074,551	
Accrued Post-Retirement Benefits	<u>391,168</u>	
TOTAL LIABILITIES		\$ 37,333,705

RESERVES

Insurance and Other	\$ 651,922,781	
Interest Maintenance	38,707,374	
Contingency Reserve		
Asset Valuation	\$ 25,419,134	
War Risk	55,403,376	
General Contingency	<u>99,864,408</u>	
Total Contingency Reserve	<u>180,686,918</u>	
TOTAL RESERVES		<u>871,317,073</u>

TOTAL LIABILITIES AND RESERVES		<u>\$ 908,650,778</u>
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See Notes to Financial Statements

Statement of Income and Reserves

STATUTORY BASIS

For the year ended 31 December 2006

INCOME		
Premiums	\$ 37,586,789	
Dues	70,395	
Consideration for supplemental contracts	192,690	
Net investment income	41,573,359	
Amortization of Interest Maintenance Reserve	<u>3,587,727</u>	\$ 83,010,960
BENEFITS AND EXPENSES		
Death benefit claims	\$ 35,307,727	
less war claims	<u>(3,124,205)</u>	
Net death benefit claims	\$ 32,183,522	
Surrender benefits	11,717,188	
Services benefits	2,387,815	
Premium refunds, term insurance	832,817	
Supplemental contracts payments	393,277	
Insurance expense		
Increase in aggregate reserves for life policies	24,012,276	
Increase in reserves for supplemental contracts	114,167	
Increase in reserves for dues	30,649	
General administrative and operating expenses	<u>6,777,824</u>	(78,449,535)
NET INCOME BEFORE EXCESS INTEREST CREDITS AND INVESTMENT TRANSACTIONS		4,561,425
Excess interest credited to policies		<u>(7,141,926)</u>
NET INCOME AFTER EXCESS INTEREST CREDITING		(2,580,501)
Net realized gain on investments (excluding Interest Maintenance Reserve losses of \$3,198,087)		<u>33,916,897</u>
NET INCOME		<u>\$ 31,336,396</u>
RESERVE TRANSACTIONS		
INSURANCE AND OTHER RESERVES, BEGINNING OF YEAR		\$ 620,623,763
Increase in reserves for life policies	\$ 24,012,276	
Increase in reserves for supplemental contracts	114,167	
Increase in reserves for dues	30,649	
Excess interest credited	<u>7,141,926</u>	
Net change in reserves for the year		<u>31,299,018</u>
INSURANCE AND OTHER RESERVES, END OF YEAR		<u>\$ 651,922,781</u>
GENERAL CONTINGENCY RESERVE		
GENERAL CONTINGENCY RESERVE, BEGINNING OF YEAR		\$ 78,047,531
Net Income	\$ 31,336,396	
Decrease in unrealized depreciation of equity securities	8,336,521	
Increase in non-admitted assets	(1,011,994)	
Decrease in Asset Valuation Reserve	1,459,954	
Increase in War Risk Reserve	<u>(18,304,000)</u>	
Net change in reserves for the year		<u>21,816,877</u>
GENERAL CONTINGENCY RESERVE, END OF YEAR		<u>\$ 99,864,408</u>

See Notes to Financial Statements

Statement of Cash Flow

STATUTORY BASIS

For the year ended 31 December 2006

CASH FLOWS FROM OPERATING ACTIVITIES

Net income		\$	31,336,396
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of Interest Maintenance Reserve	\$	(3,587,727)	
Equity earnings in subsidiaries		(5,092,198)	
Realized net gains from investments		(33,916,897)	
Amortization/accretion of bond discounts/premiums		(368,194)	
Net increase in life & other reserves		28,174,814	
Depreciation		45,219	
Bad debt expense		388,428	(14,356,555)
Changes in operating assets and liabilities:			
Increase in Accrued Investment Income	\$	(888,878)	
Increase in other assets		(105,850)	
Increase in Death Benefits Payable		1,099,531	
Increase in Accounts Payable		12,857,829	
Increase in Deferred Revenue		77,047	
Increase in Settlement Options Payable		41,505	
Decrease in Accrued Post-Retirement Benefits		(12,763)	13,068,421
NET CASH PROVIDED BY OPERATING ACTIVITIES			30,048,262

CASH FLOWS FROM INVESTING ACTIVITIES

Policy Holder loans issued	\$	(22,465,963)	
Policy Holder loan repayments		20,439,091	
Securities purchased		(524,103,201)	
Securities sold/redeemed		415,519,282	
Capital Contributions to subsidiaries		(17,804,392)	
Distribution from subsidiaries		152,270,691	
Non-admitted assets purchased		(1,022,019)	
Purchase of property and equipment		(20,640)	
NET CASH PROVIDED BY INVESTING ACTIVITIES			22,812,849
Increase in cash and cash equivalents			52,861,111
Cash and Cash Equivalents at Beginning of Year			26,180,145
CASH AND CASH EQUIVALENTS AT END OF YEAR			\$ 79,041,256

See Notes to Financial Statements

1. SIGNIFICANT ACCOUNTING POLICIES

These notes summarize major accounting policies followed by AAFMAA to prepare our financial statements. The accompanying financial statements conform to statutory accounting practices. Although AAFMAA is not subject to insurance regulation, these financial statements conform to accounting practices used by insurance companies for regulatory reporting purposes. Such accounting practices, referred to as prescribed or permitted practices, are a comprehensive basis of accounting other than generally accepted accounting principles (GAAP). Because a major objective of regulatory authorities is to protect the interests of policyholders, statutory accounting practices are oriented toward demonstrating the solvency of insurance companies and their ability to pay policyholder claims. Management believes statutory accounting practices more conservatively measure AAFMAA's financial position and results of operations. The more significant categories of differences between statutory accounting practices and GAAP are summarized below:

- Valuation of investments in bonds
- Accounting for the costs of acquiring new business
- Calculation of certain reserves for policy contract benefits
- Designation of certain assets as "non-admitted" under statutory accounting practices
- Accounting for investment in subsidiaries
- Recording of an Asset Valuation Reserve (AVR) and Interest Maintenance Reserve (IMR)

Cash and Cash Equivalents

Cash includes currency on hand and demand deposits with banks or other financial institutions. Cash equivalents are short-term highly liquid investments with original maturities of three months or less.

Investments

Investments are reported according to prescribed valuation procedures. Equities are reported at fair market value. Investments in bonds are reported at amortized cost in accordance with the National Association of Insurance Commissioners (NAIC).

Real estate mortgages, policy loans and Career Assistance Program (CAP) loans are reported at unpaid principal balances, or cost. The carrying values of loans are periodically evaluated and adjusted for any perceived impairment in value.

Interest on bonds is recorded as investment income when earned and adjusted for any amortization of premium or accretion of discount. Dividends are recorded as income when earned. Interest income from loans is recorded when earned, except on loans in foreclosure or where collection is uncertain. CAP loans are non-collateralized. CAP loans of approximately \$438,350 were written off due to non-performance during the year. This number represents about 1.5% of total CAP loans outstanding as of year-end.

Realized gains and losses on sales of investment securities are included in the Statement of Income and Reserves, except as noted in the Interest Maintenance Reserve section below. Unrealized gains and losses are included in the Contingency Reserves in the Statement of Assets, Liabilities and Reserves.

The Summary of Assets shows the amortized value and market value of each category of securities held by AAFMAA. Mortgages are private placements for which quoted market values are not available. For mortgages and policy loans, cost is used as the market value. Equity securities are reported at cost of \$139,930,919 less unrealized losses of \$9,408,642.

AAFMAA originates fixed rate commercial real estate mortgages. The loans are first lien mortgages on income producing properties with loan to value ratios of 75% or less. They have characteristics similar to conventional single-family home mortgage loans. If repaid early, there is an additional Prepayment Premium due. The Prepayment Premium is usually a percentage of the outstanding principal balance corresponding to the years left between the prepayment date and the final maturity of the loan.

AAFMAA has one wholly owned real estate investment subsidiary: Starco Properties Holding LLC. Starco Properties Holding LLC was formed on 1 January 2004 as a single member limited liability company (LLC) for the purpose of holding individual LLCs formed to own and operate real estate investment properties. This form of ownership limits risks and liabilities

from one commercial real property affecting other commercial real properties owned by AAFMAA. On 1 December 2006, AAFMAA sold each of the commercial real properties plus applicable leases, intangible property and personal property related thereto. AAFMAA will retain and continue to operate the individual LLCs for such time as is necessary to resolve certain liabilities and assets associated with its past ownership of the commercial real properties. The gross sales price was \$170,380,000, resulting in a gain from the sale of \$28,077,063. The remaining LLC assets of \$544,400 consist primarily of cash and receivables. This amount is shown on the Statement of Assets, Liabilities and Reserves as a part of Other Assets. Since 1994, AAFMAA has achieved a 9.7% annual rate of return on its investment in commercial real properties, land sales, and development, without the use of leverage.

Property and Depreciation

Under statutory accounting practices, the book values (cost less accumulated depreciation) of certain office equipment, furniture and application software are considered "non-admitted assets", i.e., assets accorded no value. As non-admitted assets, they reduce the amount in the General Contingency Reserve by the amount of their book value. As of 31 December 2006, \$1,749,995 of assets considered non-admitted reduced the General Contingency Reserve. The building, land improvements and certain other equipment (admitted assets) are being depreciated on a monthly basis. Total depreciation for the year was \$45,219.

Use of Estimates

The process of preparing financial statements requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Actuarial Reserves

Actuarial reserves for all policies are equal to the sum of the individual benefit plan accumulation values but not less than the minimum cash value for each policy. AAFMAA held certain additional reserves at 31 December 2006 such that the sum of accumulation values and these additional reserves were equal to or greater than minimum reserves for such policies as prescribed by the NAIC for regulated insurers. Excess interest credits, as reflected in the Statement of Income and Reserves, equaled the amount credited to cash value accounts in excess of statutory minimums.

Interest Maintenance Reserve (IMR)/Asset Valuation Reserve (AVR)

An IMR is maintained based upon a formula prescribed by the NAIC for the purpose of capturing the realized gains and losses resulting from changes in the overall level of interest rates. These realized gains and losses are amortized into income over the approximate remaining life of the investments had they not been sold. An AVR is maintained based upon a formula prescribed by the NAIC for the purpose of providing for default and equity risks related to AAFMAA's invested assets.

Concentration of Credit Risk

AAFMAA has a concentration risk. All of its real estate mortgages are in the Washington, DC metropolitan area. AAFMAA maintains cash balances at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. In addition, AAFMAA maintains various accounts, containing securities and cash, in trust with a large bank custodian. These accounts are uninsured.

Income Taxes

The Association is a tax-exempt, non-profit association as described in section 501(c)(23) of the Internal Revenue Code.

2. NATURE OF BUSINESS

AAFMAA was formed in 1879. It provides life insurance benefits and Survivor Assistance Services. Members consist of active, retired, reserve, and guard, officers, warrant officers, non-commissioned officers and soldiers and airmen of the US Army and US Air Force, cadets serving at the US Military Academy and US Air Force Academy, and cadets with ROTC scholarships and contracts. AAFMAA also offers insurance to the spouses, children and grandchildren of members. Spouses, children and grandchildren are NOT members unless qualified as such in their own right. AAFMAA provides interest-sensitive whole life and term life insurance and Survivor Assistance Services.

3. SECURITY IMPAIRMENT

During 2006, AAFMAA held one bond that had experienced a decline in fair value defined as "other than temporary" consistent with NAIC Accounting Practices and Procedures. AAFMAA held a \$6,000,000 par value Ford Motor Company bond bearing interest at 9.98%, purchased in 1994 for \$6,622,680, due to mature 15 February 2047. On 30 September 2006 the amortized cost of the holding was \$6,604,075. At that date, the bond was written down to \$0.89613 per par dollar, or \$5,376,780, a realized loss of \$1,227,295, as required by the NAIC. AAFMAA sold \$3,000,000 par on 4 December 2006 at a price of \$0.8975 per par dollar, or \$2,692,500, a realized gain of \$4,110, plus accrued interest. On 16 January 2007, \$2,000,000 par was sold at a price of \$0.90 per par dollar, or \$1,800,000, a realized gain of \$7,740, plus accrued interest. AAFMAA continues to hold \$1,000,000 par with an amortized cost of \$896,130.

4. RELATED-PARTY TRANSACTIONS

Armed Forces Services Corporation (AFSC) was created 1 July 2000 to provide Living Services and Survivor Assistance Services under contract to AAFMAA. For the year ending 31 December 2006, AAFMAA incurred servicing expenses of \$2,387,815.

5. EMPLOYEE BENEFITS**Retirement Plan**

AAFMAA has a 401(k) and profit-sharing plan that covers all employees who meet certain minimum eligibility requirements. AAFMAA may contribute as a matching contribution up to 6% of employee compensation. In addition, AAFMAA may contribute an amount equal to 3% of compensation. The total retirement plan expense for the year ended 31 December 2006 was \$530,792, which includes \$290,178 of employees' elective deferrals.

Life Insurance

AAFMAA self-insures each employee for \$50,000 after one year of employment. Employees may obtain additional life insurance coverage with AAFMAA at their own expense if they qualify. Employees are NOT members of AAFMAA unless qualified as such in their own right.

6. POST- RETIREMENT BENEFITS

All retiree benefits have been eliminated except for those retirees and/or surviving spouses of retirees previously covered under the retiree health care plan. There are currently four retirees covered under the retiree health care plan until death. Retiree health care plan costs to AAFMAA in 2006 were \$9,252. The retiree health care plan costs AAFMAA 40% of premiums or a fixed monthly amount for select retirees; the retiree contributes 60%. The projected, cumulative obligations are \$38,349.

Participation in the IRS Code Section 457 Deferred Compensation Plan was discontinued 31 December 1996. The deferred compensation plan was funded with deferrals from the compensation of the participants. At their 13 December 2006 meeting, the Board of Directors passed a resolution to terminate the plan effective 2 January 2007 and distribute the proceeds. The three remaining participants will receive distribution of plan assets as soon as is administratively practical in 2007. As of 31 December 2006, the total value of the assets in the plan was \$352,819.

7. COMMITMENTS

AAFMAA has committed \$2,396,370 to AFSC to provide services to AAFMAA's members for 2007. As of 31 December 2006, the Association is committed to fund \$2,646,400 for real estate mortgage loans.

8. LAND LEASE

In December 1998, AAFMAA entered into a 30-year agreement with the Department of the Army to lease the land upon which AAFMAA's building is located at Fort Myer, VA. The current year annual lease payment is \$13,455, which is subject to change based on an evaluation of fair market rental value to be performed every five years.

9. SUBSEQUENT EVENT

In late February 2007, AAFMAA received a letter from the North Carolina Department of Insurance (NCDOI), advising AAFMAA to stop life insurance sales in that state until it became licensed by the NCDOI. AAFMAA has complied by voluntarily suspending sales in North Carolina. Management feels that AAFMAA is not subject to North Carolina's licensure requirements pursuant to a specific article within their state statutes, and is currently pursuing a legislative remedy. They believe that a positive resolution of this matter is probable.

TO THE BOARD OF DIRECTORS, ARMY AND AIR FORCE MUTUAL AID ASSOCIATION

We have audited the accompanying statutory basis statements of assets, liabilities and reserves of Army and Air Force Mutual Aid Association as of December 31, 2006, and the related statutory basis statements of income and reserves and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described more fully in Note 1 to the financial statements, the Association prepared these financial statements using accounting practices prescribed or permitted by the National Association of Insurance Commissioners, which practices differ from generally accepted accounting principles (GAAP). The effects on the financial statements of the variances between the statutory basis of accounting and GAAP, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present, and are not intended to present in conformity with GAAP, the financial position of Army and Air Force Mutual Aid Association as of December 31, 2006, or the results of its operations or its cash flows for the year then ended.

In our opinion, the statutory basis financial statements referred to above do present fairly, in all material respects, the financial position of Army and Air Force Mutual Aid Association as of December 31, 2006, and the results of its operations and its cash flows for the year then ended, on the basis of accounting described in Note 1.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information (Summary of Assets – 31 December 2006) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

BERLIN, RAMOS & COMPANY, P.A.

March 23, 2007

STARCO PORTFOLIO SOLD

\$28 Million Gain

For the past six years you've seen a success story unfold on this page, either as Consolidated Realty or more recently as Starco Properties. AAFMAA participates in the Washington, DC metropolitan area commercial mortgage market as a direct lender. Successful lending depends upon two significant factors: interest rate appropriate for risk and economic value of the property collateralizing the loan. If the borrower succeeds, AAFMAA receives an above market interest rate compared to investment alternatives with similar risk. If the borrower fails, AAFMAA receives the commercial real estate collateralizing the loan.

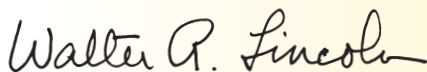
As a lender, AAFMAA adheres to the adage: if you loan, plan to own. Even considering the relative strength of the Washington, DC area, inevitably, some loans will default. AAFMAA established Starco Properties to reposition buildings and parcels of raw land received as a result of loan defaults. Starco aggressively leased existing buildings to generate income and developed raw land with new buildings, which were also aggressively leased. Expansion occurred only when financially prudent. Property management focused on tenant satisfaction, which generated excellent retention. This yielded an average annual rate of return of approximately 7%, **even after depreciation expense**. Essentially, Starco Properties uncovered intrinsic value coveted by other real estate investors.

Starco's 2006 property review valued the individual properties at \$143 million and the total portfolio at \$155 million. Usually when buying in bulk, the buyer receives a discount. Our research confirmed the opposite — buyers were willing to pay a

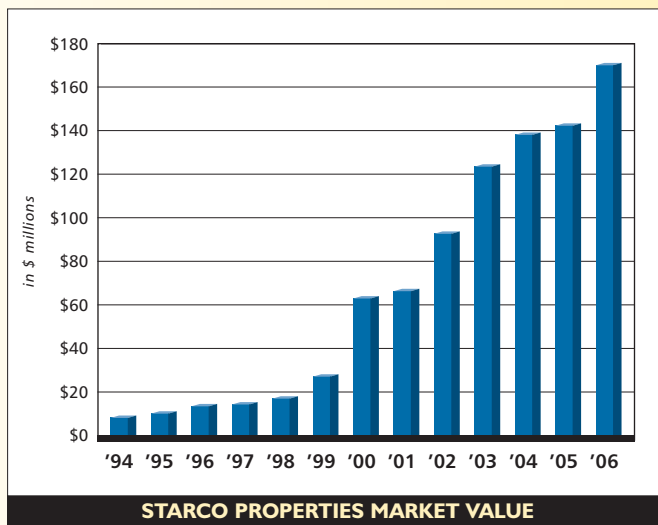
premium to purchase all 10 Starco properties in a single transaction! On 1 December 2006, AAFMAA completed the sale of the Starco portfolio for a gross sales price of over \$170 million.

For the great benefit of all members and policy holders, I'm delighted to report that we achieved a gain of over \$28 million from the Starco sale. This is the largest single gain in AAFMAA's history. Such results can be achieved because of a talented, competent investment team and dedication to a long term, patient investment philosophy which allows prices to rise to meet value.

Sincerely,



WALTER R. LINCOLN, CFP®
President and Treasurer
Starco Properties Holding LLC



Starco Properties



AAFMAA's Investment Team, including Matt Watson, Walt Lincoln, Charlie Betancourt and Gary Aiken.

We achieved a gain of over \$28 million from the Starco sale. This is the largest single gain in AAFMAA's history. ■



A Tradition of Protecting Army and Air Force Members and Families for 128 Years

AAFMAA was established in 1879 by military members for military members to aid the families of deceased soldiers with their final expenses. AAFMAA always puts the members' best interests first, from the purchase of the first policy to the final payout of the death benefit.



AAFMAA's Survivor Assistance Services

At the heart of our 128 year tradition "to aid the families of the deceased members in a prompt, simple, and substantial manner," and included with every member's policy, are AAFMAA's Survivor Assistance Services.

These include:

- ★ Expedient payment of the death benefit
- ★ Claims initiation, plus continuous follow-up
- ★ Claims representation, plus follow-up in disputes
- ★ Lifetime individualized benefit notification
- ★ Social Security notification
- ★ Financial Awareness Service
- ★ Annual statement of spouse entitlements

AAFMAA Products



LEVEL TERM I

Inexpensive term life insurance designed for active duty members and spouses under age 45. A great supplement or alternative to SGLI.

- ★ Level premium and death benefit to age 50 (40 for nicotine users)
- ★ Annual premium refunds for non-nicotine users, NOT guaranteed but paid since inception
- ★ Save up to 39% over SGLI
- ★ Up to \$10,000 coverage, at no additional cost, for eligible children with member's policy
- ★ Same low rates for member and spouse
- ★ Children and grandchildren age 18-23 are also eligible for coverage

Compare these rates before you make your decision.

COVERAGE	AAFMAA*	AFTER REFUND*	SGLI**
\$100,000	\$ 5.90	\$ 5.90	\$ 7.00
\$250,000	\$13.00	\$11.70	\$17.50
\$400,000	\$19.00	\$17.10	\$28.00
\$600,000	\$27.00	\$24.30	N/A
\$800,000	\$35.00	\$31.50	N/A

*Monthly rates. Non-nicotine users receive 10% annual premium refund on policies over \$100,000, NOT guaranteed and subject to change.

**Premium shown does not include \$1.00 charge for TSGLI.

Subject to complete terms and conditions of the policy. Not available in all states.



LEVEL TERM II

One of AAFMAA's most flexible, cost effective types of coverage designed for members and spouses generally over age 45. A great alternative to VGLI.

- ★ You pick the coverage amount (\$50,000 – \$800,000) and term (5 to 30 years)
- ★ Coverage can last up to age 85
- ★ Low-cost female rates
- ★ Great for spouse coverage!
- ★ Rate NEVER increases/death benefit NEVER decreases for the life of the policy
- ★ Must be purchased before age 76

20 Year Level Term II, Non-nicotine user, Super Select* monthly rate

ISSUE AGE	COVERAGE AMOUNT					
	\$100,000		\$250,000		\$500,000	
	MALE	FEMALE	MALE	FEMALE	MALE	FEMALE
45	\$15.20	\$12.10	\$ 30.50	\$22.75	\$ 56.00	\$ 40.50
50	\$20.80	\$15.50	\$ 44.50	\$31.25	\$ 84.00	\$ 57.50
55	\$30.40	\$22.60	\$ 68.50	\$49.00	\$132.00	\$ 93.00
60	\$46.60	\$33.60	\$109.00	\$76.50	\$213.00	\$148.00

*This is our BEST RATE CLASS. Rates may be higher depending on individual health and lifestyle. Subject to complete terms and conditions of the policy. Not available in all states.

Who can be a member? All ranks of Army and Air Force, active duty, retired, National Guard and Reserve below the age of 66, USMA and USAFA cadets, and ROTC contract and scholarship cadets are eligible for membership.

VALUE-ADDED WHOLE LIFE

The protection of permanent insurance, plus the cash value growth of interest sensitive life insurance.



- ★ 100% money back guarantee for life (total premiums paid or cash value, whichever is GREATER)
- ★ Premiums guaranteed to NEVER increase
- ★ Borrow up to 75% of the cash value at 1% above the current crediting rate
- ★ Great crediting rate (7.1% for 2007) — Guaranteed 4.5%

- ★ Long Term Care Settlement Option included with policy
- ★ Flexible payments — Single Payment, 7, 20, 30 years, or Pay to age 100
- ★ Can be purchased through age 79 for members and spouses, and through age 23 for children and grandchildren

ANNUITYLIFE

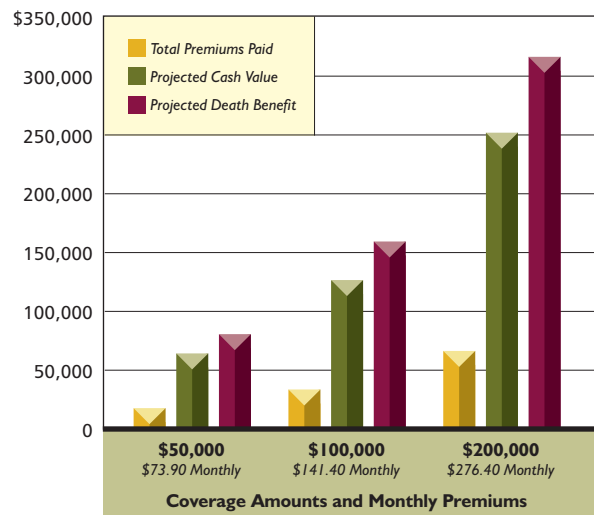


The benefits of Value-Added Whole Life with minimal underwriting, regardless of age, sex or nicotine use.

- ★ Minimal medical underwriting — only 3 questions
- ★ Requires payment of single premium
- ★ Option to annuitize the cash value immediately, at a later date, or never
- ★ If annuitized, guaranteed payments to age 100 at 4%, with an annual “bonus” check if Net Yield on Assets exceeds 4%
- ★ Can be purchased up to age 99

35 YEAR PROJECTION

Issued at age 45, premiums paid monthly for 20 years, projected crediting rate of 7.1%, NOT guaranteed and subject to change.



Subject to complete terms and conditions of the policy. Not available in all states.

All AAFMAA Policies Offer These Valuable Features:

- ★ NO war clause, NO aviation clause, NO terrorist clause
- ★ Can continue after separation or retirement from the military
- ★ Survivor Assistance Services included with every member's policy
- ★ No coverage limitations based upon rank or deployment status
- ★ Coverage available up to \$800,000

ARMY AND AIR FORCE MUTUAL AID ASSOCIATION

102 Sheridan Avenue
Ft Myer, VA 22211-1110

Toll Free: 1-800-522-5221

Local: 703-522-3060

Fax: 703-522-1336

E-mail: info@aafmaa.com

Web Site: www.aafmaa.com

Main Office Hours: Monday – Friday, 8:30 AM – 4:30 PM Eastern Time

Membership and Insurance Sales Telephone Hours
until 7:00 PM at 1-877-398-2263



*Insurance from a name you can trust... **AAFMAA***

STABILITY • REPUTATION • LOW COST • SINCE 1879

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