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*Puerto Rico Farm Credit, ACA*  
***FIRST QUARTER 2002***

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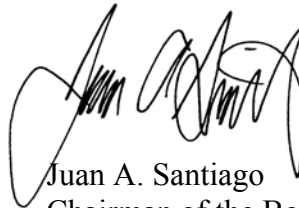
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William A. Garrahan  
Chief Executive Officer



Juan A. Santiago  
Chairman of the Board

April 29, 2002

# Management's Discussion and Analysis of Financial Condition and Results of Operations

*(dollars in thousands)*

The following commentary reviews the consolidated financial condition and results of operations of Puerto Rico Farm Credit, ACA (Association) for the three months ended March 31, 2002. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2001 annual report of the Association.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related business for financing short and intermediate-term loans and long-term real estate mortgage loans. The Association also maintains a portfolio of purchased syndicated loans, originated by other Farm Credit System entities and non-system entities. The Association's predominant local service area (LSA) agricultural commodities were dairy, livestock and fruits which totaled approximately \$99 million or 54 percent of all outstanding loan volume at March 31, 2002.

The gross loan volume of the Association at March 31, 2002 was \$178,343, an increase of \$5,300 or 3.1 percent as compared to \$173,043 at December 31, 2001. Net loans outstanding at March 31, 2002 also increased, but by \$5,474, as a result of a \$174 reduction in the allowance for loan losses. The improvement in gross loan volume was primarily related to increases in the dairy and rural home loan industries and to additional loan volume purchased from syndications. These increase more than offsets declines in LSA industries that have scheduled annual payments during the first quarter.

Net loans at March 31, 2002 made up 95.9 percent of total assets, compared to 95.6 percent as December 31, 2001. At March 31, 2001 the percentage was 94.7 percent. The increase during the past twelve months reflected the \$12,507 increase in loan volume and reductions in all other categories of assets.

As a percentage of gross loans, nonaccrual loans equaled 2.4 percent, compared with 2.5 percent and 3.9 percent at December 31, 2001 and March 31, 2001, respectively. The decrease in the percentage was primarily the result of a partial payment received from the sale of collateral property related to a large volume account during the second half of 2001. There is a plan in place to liquidate the remaining collateral during 2002. When this one large volume account is finalized, nonaccrual loans should approximate 1.25 percent of gross loans. Due to the substantial increase in loan volume, the overall credit quality of the total portfolio continued to show improvement. Credit quality has also been supported and enhanced by the lower interest rate environment, favorable weather and stable product demand.

The Association maintained an allowance for loan losses in an amount considered by management as sufficient to absorb the estimated risk inherent in the loan portfolio. The allowance for loan losses decreased from \$6,674 at December 31, 2001 to \$6,500 at March 31, 2002. The reduction of \$174 reflected management's updated analysis of the risk of loss in the portfolio. The analysis identified less risk as a result of a lower level of nonaccrual loans and improved credit quality. The ratio of allowance to gross loan

volume was 3.6 percent at March 31, 2002 and 3.9 percent at December 31, 2001. There were no charge-offs during the first quarter of 2002 and recoveries totaled less than \$1.

## **RESULTS OF OPERATIONS**

Net income for the three months ended March 31, 2002 totaled \$812, a decrease of \$50 or 5.8 percent as compared to the first quarter of 2001. Despite the higher level of accruing loan volume and the reduction in nonaccruing loan volume, the significantly lower interest rate environment resulted in a reduction of \$446 in interest expense credits earned from *AgFirst Farm Credit Bank* (Bank), negatively impacting net interest income.

Net interest income at March 31, 2002 was \$1,530 a decrease of \$478 or 23.8 percent compared to the first quarter of 2001 when net interest income was \$2,008. During the first quarter of 2002 interest income recognized from the collection of nonaccrual loans totaled \$176, almost identical to the \$175 recognized during the first quarter of 2001. Management does not anticipate interest income from nonaccrual loans to continue through the last three quarters of 2002 at such an accelerated pace.

During the first quarter of 2002, a decision by management to reduce the allowance for loan losses resulted in a \$174 reversal of provision which enhanced income. Noninterest income for the three months ended March 31, 2002 was \$66, a decrease of \$12 as compared to the first three months of 2001. Primarily this was the result of decreased fee income from the recognition of prepayment penalties related to rural housing loans and late charge penalties from installments paid after the due date.

Noninterest expense for the three months ended March 31, 2002 decreased by \$419 or 30.9 percent compared to the same period of 2001. The decrease was primarily related to the absence of restructuring expenses during 2002, as opposed to 2001 when restructuring expenses totaled \$435 during the first quarter. Despite reductions in other expense categories as a result of 2001's restructuring, salaries and employee benefits increased by \$38 or 6.3 percent from the first quarter of 2001. Actual salary expense decreased; however, benefits expense primarily related to pension and retiree health care increased by \$72.

During the first quarter of 2002, the Association incurred federal tax expense of \$21, \$15 related to the first quarter's tax provision expense and \$6 related to the filing of the 2001 federal tax return. This compared to first quarter 2001 when the Association recognized tax provision expense of \$10 and \$11 related to filing the 2000 federal return. However, first quarter of 2001 net income was materially enhanced as a prior period adjustment for \$153 was recorded upon signing a closing agreement with the IRS related to an amend 1999 federal tax return.

Management projects that 2002's federal income tax expense will be an enhancement to final net income, similar to 2001. During either the second or third quarter of 2002, the Association expects to sign a closing agreement with the IRS related to an amended 2000 federal tax return. When the agreement is signed the Association will recognize a prior period adjustment for \$193. Additionally, as management refines the holding company structure established during 2001, it is projected that the resultant federal tax liability and related provision expense will decrease.

### Key Results of Operations Ratios:

	Annualized for the three months ended 3/31/02	For the year ended 12/31/01
Return on Average Assets	1.85%	2.18%
Return on Average Stockholders' Equity	7.21%	8.28%
Net Interest Income as a Percentage of Average Earning Assets	3.57%	4.56%

### LIQUIDITY AND FUNDING SOURCES

#### Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. Sufficient liquid funds have been available to meet all financial obligations.

#### Funding Sources

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate notes are utilized by the Association to fund variable rate loan advances and operating funds requirements. The total notes payable to the Bank at March 31, 2002 was \$132,160 as compared with \$126,564 at December 31, 2001. The increase of \$5,596 or 4.4 percent very closely corresponded to the \$5,300 increase in gross loan volume during the first quarter.

The Association had no lines of credit outstanding with third parties as of March 31, 2002.

#### Funds Management

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers variable rate loan products which are competitively priced according to financial market rates. Variable rate loans may be indexed to either the Prime rate or the 90-day London Interbank Offered Rate (LIBOR). The majority of the interest rate risk in the Association balance sheet is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control interest rate risk associated with the loan portfolio.

### CAPITAL RESOURCES

Total stockholders' equity at March 31, 2002 increased 1.7 percent to \$45,457 from December 31, 2001 when total stockholders' equity was \$44,686. The increase was attributable to net income retained as unallocated surplus during the quarter.

Total capital stock and participation certificates were \$987 on March 31, 2002 compared to \$974 on December 31, 2001. The increase of \$13 was the net result of new customers purchasing more stock than was refunded to borrowers who paid their loans in full.

Retained earnings unallocated increased \$758 or 1.7 percent from December 31, 2001 when unallocated retained earnings totaled \$43,712. The increase was net income in excess of equity dividends declared. The Association's directors declared cash dividends for the thirty-fifth consecutive quarter. The table below sets forth the amount of dividends declared:

Quarter	Equity Based	Patronage Based
First 2002	\$49	
Fourth 2001		\$1,238
Third 2001	\$49	
Second 2001	\$49	
First 2001	\$50	
Fourth 2000		\$1,102

The Board of Directors intends to continue its policy of declaring quarterly cash dividends. However, the fourth quarter's dividend will be based on client patronage, rather than equity ownership. The amount of dividends, as always, will depend on continued strong earnings, the overall financial condition of the Association and other factors.

The Association's regulatory permanent capital ratio at March 31, 2002 was 28.14 percent compared to 28.98 percent at December 31, 2001. The decrease in the ratio reflected an increase in weighted average assets during the first quarter, as a result of higher gross loan volume. The Association's total surplus and core surplus ratios were both 27.42 percent at March 31, 2002. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

#### Key financial condition ratios were as follows:

	3/31/02	12/31/01
Stockholders' Equity to Assets	25.36%	25.69%
Debt to Stockholders' Equity	2.94:1	2.89:1

### IRS TAX SETTLEMENT

As previously disclosed in the 2000 Annual Report and updated in the 2001 Annual Report, System ACAs entered into a settlement process with the IRS to resolve conclusively the status of all claimed refunds and the ongoing tax status of the ACAs using another ACA as a model. In August 2000, the model ACA reached a settlement agreement with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities and provided for 60 percent of the refund claimed to be returned to the ACA, plus interest for the applicable periods.

During the second quarter of 2001, the Association submitted to the IRS an amended 2000 federal tax return. Management expects to receive a signed agreement from the IRS during the second quarter of 2002 and a refund check during the second half of 2002. Thus, like 2001, the 2002 financial statements are projected to reflect a net federal tax benefit enhancing net income by approximately \$150.

*Puerto Rico Farm Credit, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>2002</b>	<b>March 31, 2001</b>	<b>December 31, 2001</b>
	<i>(unaudited)</i>		
<b>Assets</b>			
Cash and cash equivalents	\$ 20	\$ 52	\$ 37
Loans	178,343	165,836	173,043
Less: allowance for loan losses	6,500	6,680	6,674
Net loans	171,843	159,156	166,369
Accrued interest receivable	918	1,655	1,026
Investment in <i>Ag First Farm Credit Bank</i>	4,712	5,236	4,712
Premises and equipment, net	777	941	808
Other property owned	—	29	10
Other assets	979	1,071	1,005
Total assets	<u>\$ 179,249</u>	<u>\$ 168,140</u>	<u>\$ 173,967</u>
<b>Liabilities</b>			
Notes payable to <i>Ag First Farm Credit Bank</i>	\$ 132,160	\$ 123,050	\$ 126,564
Accrued interest payable	189	491	154
Dividends payable	50	50	1,233
Other liabilities	1,393	1,321	1,330
Total liabilities	<u>133,792</u>	<u>124,912</u>	<u>129,281</u>
Commitments and contingencies			
<b>Stockholders' Equity</b>			
Capital stock and participation certificates	987	995	974
Retained earnings			
Unallocated	44,470	42,233	43,712
Total stockholders' equity	<u>45,457</u>	<u>43,228</u>	<u>44,686</u>
Total liabilities and stockholders' equity	<u>\$ 179,249</u>	<u>\$ 168,140</u>	<u>\$ 173,967</u>

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

*Puerto Rico Farm Credit, ACA*  
**Consolidated Statements of Income**  
*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended March 31,</b>	
	<b>2002</b>	<b>2001</b>
<b>Interest Income</b>		
Loans	\$ 2,068	\$ 3,612
<b>Interest Expense</b>		
Notes payable to Ag <b>First Farm Credit Bank</b>	538	1,604
Net interest income	1,530	2,008
Provision for (reversal of) loan losses	(174)	—
Net interest income after provision for (reversal of) loan losses	1,704	2,008
<b>Noninterest Income</b>		
Loan fees	41	56
Fees for financially related services	3	3
Miscellaneous	22	19
Total noninterest income	66	78
<b>Noninterest Expense</b>		
Salaries and employee benefits	639	601
Occupancy and equipment	53	71
Insurance Fund premium	15	3
Guarantee fee	45	37
Other operating expenses	185	208
Restructuring charges	—	435
Losses on other property owned, net	—	1
Total noninterest expense	937	1,356
Income before income taxes	833	730
Provision (benefit) for income taxes	21	(132)
Net income	\$ 812	\$ 862

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

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*Puerto Rico Farm Credit, ACA*

## Consolidated Statements of Changes in Stockholders' Equity

*(unaudited)*

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<i>(dollars in thousands)</i>	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings Unallocated</b>	<b>Total Stockholders' Equity</b>
Balance at December 31, 2000	\$ 1,012	\$ 41,421	\$ 42,433
Net income		862	862
Capital stock/participation certificates issued	15		15
Capital stock/participation certificates retired	(32)		(32)
Cash dividends declared		(50)	(50)
Balance at March 31, 2001	\$ 995	\$ 42,233	\$ 43,228
Balance at December 31, 2001	\$ 974	\$ 43,712	\$ 44,686
Net income		812	812
Capital stock/participation certificates issued	32		32
Capital stock/participation certificates retired	(19)		(19)
Cash dividends declared		(49)	(49)
Dividend adjustment		(5)	(5)
Balance at March 31, 2002	\$ 987	\$ 44,470	\$ 45,457

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

*Puerto Rico Farm Credit, ACA*

# Notes to Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

## **NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

A description of the organization and operations of Puerto Rico Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2001, are contained in the 2001 Annual Report to Stockholders. These unaudited first quarter 2002 consolidated financial statements should be read in conjunction with the 2001 Annual Report to Stockholders.

As disclosed in the 2001 Annual Report, pursuant to a plan of restructuring approved by the Farm Credit Administration and Association shareholders, the Association reorganized its corporate structure effective July 1, 2001. Pursuant to this restructuring, a Federal Land Credit Association (FLCA) and Production Credit Association (PCA) were formed as wholly owned subsidiaries of the Association. The formation of these subsidiaries enables the Association to take advantage of the tax-exempt status of long-term mortgage interest for loans held by the FLCA. This restructuring was accounted for as a reorganization of entities under common control similar to a pooling of interests.

Prior to the restructuring, the ACA was subject to federal income tax. As a result of the restructuring, long-term lending activity has been participated into a wholly owned FLCA subsidiary, which is exempt from federal income tax. The ACA, which is the holding company, along with the wholly owned PCA subsidiary, will continue to be subject to income tax.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the three months ended March 31, 2002, are not necessarily indicative of the results to be expected for the year ending December 31, 2002.

Certain amounts in prior period consolidated financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of March 31, 2002, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

## **NOTE 2 — ALLOWANCE FOR LOAN LOSSES**

An analysis of the allowance for loan losses follows:

Balance at 12-31-00	\$6,680
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	—
Balance at 3-31-01	<u>\$6,680</u>
Balance at 12-31-01	\$6,674
(Reversal of) provision for loan losses	(174)
Recoveries, net of loans charged off	—
Balance at 3-31-02	<u>\$6,500</u>

## **NOTE 3 — COMMITMENTS AND CONTINGENT LIABILITIES**

Actions are pending against the Association in which money damages are sought. However, on the basis of information now at hand, management and legal counsel are of the opinion that the ultimate liability, if any, resulting therefrom, would not be material in relation to the overall financial position of the Association.