



SECOND QUARTER 2003

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William A. Garrahan
Chief Executive Officer



Juan A. Santiago
Chairman of the Board

July 29, 2003

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 six months ended June 30, 2003. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2002 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 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 \$118 million or 52 percent of all outstanding loan volume at June 30, 2003.

The gross loan volume of the Association at June 30, 2003 was \$222,158, an increase of \$17,648 or 8.6 percent when compared to \$204,510 at December 31, 2002. Net loans outstanding at June 30, 2003 also increased by the same amount and percent, as there was no change in the allowance for loan losses. The material increase in gross loan volume was split almost evenly between participation loans and LSA originated loans. The Association intends to continue to grow the loan portfolio either through LSA lending or participations, as the opportunities present themselves.

Net loans at June 30, 2003 made up 96.9 percent of total assets, the same percentage as at December 31, 2002. This reflected the decrease in other assets recorded during the fourth quarter of 2002, recognizing the underfunded status of the retirement plan, and the elimination of the related prepaid assets.

As a percentage of gross loans, nonaccrual loans equaled 1.8 percent, compared with 2.2 percent and 2.4 percent at December 31, 2002 and June 30, 2002, respectively. The decrease in the percentage was primarily the result of a partial payment received from the sale of collateral property associated with a large volume nonaccrual account. There is a plan in place to liquidate the remaining collateral. Due to the material increase in gross loan volume, the overall credit quality of the portfolio showed improvement during the first half of 2003. Credit quality was also supported by improved delinquency trends, favorable weather and local 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 was unchanged during the first half of 2003, as there were no charge offs or recoveries. The ratio of allowance to gross loan volume declined to 2.9 percent at June 30, 2003 from 3.2 percent at December 31, 2002 primarily as a result of the increase in loan volume.

RESULTS OF OPERATIONS

Net income for the six months ended June 30, 2003 totaled \$1,020 a decrease of \$359 or 26 percent compared to the same six-month period of 2002. This decrease was primarily the result of noninterest related items. Increased interest income from higher levels of accruing loans was mostly offset by decreases in the collection of memo interest income from nonaccruing loans.

At June 30, 2003 net interest income was \$2,908, a decrease of \$104 or 3.5 percent when compared to June 30, 2002 total of \$3,012. During the first six months of 2003, interest income recognized from the collection of nonaccrual loans totaled \$178, a reduction of \$95 from the first two quarters of 2002. Management continues to project lower levels of memo interest income from nonaccrual loans, negatively impacting net interest income comparisons on a year-over-year basis.

During the first half of 2002 income was enhanced by \$174, as a result of a decision by management to reduce the allowance for loan losses. During the first half of 2003 the allowance was not changed, resulting in no change to income.

Noninterest income for the six months ended June 30, 2003 totaled \$171, an increase of \$56 or 49 percent as compared to the first six months of 2002. This was primarily the result of increased fee income related to the participation loan portfolio and an experience dividend related to credit life insurance services.

Noninterest expense for the six months ended June 30, 2003 was \$2,058 compared to \$1902 at June 30, 2002. The increase of \$156 was primarily related to salaries and employee benefits and the FCS Insurance Corporation's premium. Despite stability in actual salaries expense, employee benefits related to pension and post-retirement medical insurance increased, resulting in a net increase of \$83. The insurance fund premium totaled \$122, an increase of \$91 during the first half of 2003. Management projects this higher level of premium expense to continue through the second half of 2003.

The Association's 2003 federal tax liability continued to benefit from the restructuring efforts into a holding company. A majority of the Association's business has been conducted in the tax-exempt subsidiary. Taxable possession-sourced activity continues to be eligible for tax credits. Thus, no provision for federal income tax expense was recorded for either the first or second quarters.

For the three months ended June 30, 2003.

Net income for the second quarter of 2003 was \$580 compared to \$567 for the second quarter of 2002. Net interest income and noninterest income both increased by \$33, reflecting the material increase in accruing loan volume and participation loan servicing fees.

Noninterest income was also enhanced by receipt of an experience refund dividend related to credit life insurance services provided to borrowers.

These enhancements to net income were partially offset by increased noninterest operating expenses which increased by \$52 during the second quarter.

Key Results of Operations Ratios:

	Annualized for the six months ended 6/30/03	For the year ended 12/31/02
Return on Average Assets	.98%	2.15%
Return on Average Stockholders' Equity	4.47%	8.57%
Net Interest Income as a Percentage of Average Earning Assets	2.84%	3.34%

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 AgFirst Farm Credit Bank (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 June 30, 2003 was \$173,436 as compared with \$154,689 at December 31, 2002. The increase of \$18,747 or 12.1 percent very closely corresponded to the \$17,648 increase in gross loan volume during the first half of 2003.

The Association had no lines of credit outstanding with third parties as of June 30, 2003.

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 June 30, 2003 increased 2.1 percent to \$45,812 from December 31, 2002 when total stockholders' equity was \$44,877. The increase was attributable to net income retained as unallocated surplus during the quarter.

Total capital stock and participation certificates were \$1,018 on June 30, 2003 compared to \$1,001 on December 31, 2002. The net increase was the result of new customers purchasing more stock than was refunded to borrowers who paid their loans in full.

Retained earnings unallocated increased \$918 or 2.0 percent from December 31, 2002 when unallocated retained earnings totaled \$45,914. The increase was net income in excess of equity dividends declared. The Association's directors declared cash dividends for the forty-second consecutive quarter. The table below sets forth the amount of dividends declared:

<u>Quarter</u>	<u>Equity Based</u>	<u>Patronage Based</u>
Second 2003	\$51	
First 2003	\$51	
Fourth 2002		\$1,602
Third 2002	\$50	
Second 2002	\$50	
First 2002	\$49	
Fourth 2001		\$1,238

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 June 30, 2003 was 25.40 percent compared to 25.03 percent at December 31, 2002. The decrease in the ratio reflected an increase in weighted average assets during the first six months, as a result of higher gross

loan volume. The Association's total surplus and core surplus ratios were both 24.80 percent at June 30, 2003. 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:

	6/30/03	12/31/02
Stockholders' Equity to Assets	20.59%	21.96%
Debt to Stockholders' Equity	3.86:1	3.55:1

Puerto Rico Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	June 30,		December 31,
	2003	2002	2002
	<i>(unaudited)</i>		
Assets			
Cash	\$ 273	\$ 9	\$ 92
Loans	222,158	182,448	204,510
Less: allowance for loan losses	6,498	6,501	6,498
Net loans	215,660	175,947	198,012
Accrued interest receivable	1,053	1,008	816
Investment in AgFirst Farm Credit Bank	4,712	4,712	4,712
Premises and equipment, net	547	783	474
Other property owned	22	—	—
Other assets	191	1,085	217
Total assets	<u>\$ 222,458</u>	<u>\$ 183,544</u>	<u>\$ 204,323</u>
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 173,436	\$ 135,836	\$ 154,689
Accrued interest payable	230	189	153
Dividends payable	51	50	1,602
Postretirement benefits other than pensions	1,084	939	978
Minimum pension liability	1,187	—	1,260
Other liabilities	658	549	764
Total liabilities	<u>176,646</u>	<u>137,563</u>	<u>159,446</u>
Commitments and contingencies			
Stockholders' Equity			
Capital stock and participation certificates	1,018	994	1,001
Unallocated retained earnings	46,832	44,987	45,914
Accumulated other comprehensive income (loss)	(2,038)	—	(2,038)
Total stockholders' equity	<u>45,812</u>	<u>45,981</u>	<u>44,877</u>
Total liabilities and stockholders' equity	<u>\$ 222,458</u>	<u>\$ 183,544</u>	<u>\$ 204,323</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>	For the three months ended June 30,		For the six months ended June 30,	
	2003	2002	2003	2002
Interest Income				
Loans	\$ 2,181	\$ 2,053	\$ 4,202	\$ 4,121
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	666	571	1,294	1,109
Net interest income	1,515	1,482	2,908	3,012
Provision for (reversal of) loan losses	—	—	—	(174)
Net interest income after provision for (reversal of) loan losses	1,515	1,482	2,908	3,186
Noninterest Income				
Loan fees	57	44	124	85
Fees for financially related services	24	4	28	7
Miscellaneous	1	1	19	23
Total noninterest income	82	49	171	115
Noninterest Expense				
Salaries and employee benefits	648	623	1,345	1,262
Occupancy and equipment	53	58	106	111
Insurance Fund premium	62	16	122	31
Guarantee fee	59	45	116	90
Other operating expenses	195	223	369	408
Total noninterest expense	1,017	965	2,058	1,902
Income before income taxes	580	566	1,021	1,399
Provision (benefit) for income taxes	—	(1)	1	20
Net income	\$ 580	\$ 567	\$ 1,020	\$ 1,379

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

Puerto Rico Farm Credit, ACA

Consolidated Statements of Changes in Stockholders' Equity

(unaudited)

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2001	\$ 974	\$ 43,712	\$ —	\$ 44,686
Net income		1,379		1,379
Capital stock/participation certificates issued	63			63
Capital stock/participation certificates retired	(43)			(43)
Cash dividends declared		(99)		(99)
Distribution adjustment		(5)		(5)
Balance at June 30, 2002	\$ 994	\$ 44,987	\$ —	\$ 45,981
Balance at December 31, 2002	\$ 1,001	\$ 45,914	\$ (2,038)	\$ 44,877
Net income		1,020		1,020
Capital stock/participation certificates issued	50			50
Capital stock/participation certificates retired	(33)			(33)
Cash dividends declared		(102)		(102)
Balance at June 30, 2003	\$ 1,018	\$ 46,832	\$ (2,038)	\$ 45,812

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

Notes to the 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, 2002, are contained in the 2002 Annual Report to Stockholders. These unaudited second quarter 2003 consolidated financial statements should be read in conjunction with the 2002 Annual Report to Stockholders.

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 six months ended June 30, 2003, are not necessarily indicative of the results to be expected for the year ending December 31, 2003.

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 June 30, 2003, 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 12-31-01	\$ 6,674
(Reversal of) provision for loan losses	(174)
Recoveries, net of loans charged off	<u>1</u>
Balance at 6-30-02	<u>\$ 6,501</u>
Balance at 12-31-02	\$ 6,498
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	<u>—</u>
Balance at 6-30-03	<u>\$ 6,498</u>

NOTE 3 – COMMITMENTS AND CONTINGENT LIABILITIES

Actions are pending against the Association in which claims for money damages are asserted. Upon the basis of current information, management and legal counsel are of the opinion that the ultimate liability, if any, resulting there from, would not be material in relation to the financial position of the Association.