
Puerto Rico Farm Credit, ACA
THIRD QUARTER 2002

Management's Discussion and Analysis of
Financial Condition and Results of Operations2

Consolidated Financial Statements

Consolidated Balance Sheets5

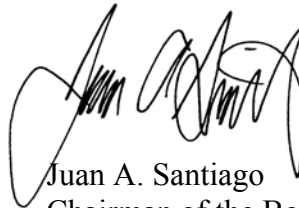
Consolidated Statements of Income.....6

Consolidated Statements of Changes in Stockholders' Equity7

Notes to the Consolidated Financial Statements.....8



William A. Garrahan
Chief Executive Officer



Juan A. Santiago
Chairman of the Board

October 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 nine months ended September 30, 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 \$105 million or 54 percent of all outstanding loan volume at September 30, 2002.

The gross loan volume of the Association at September 30, 2002 was \$189,239, an increase of \$16,196 or 9.4 percent when compared to \$173,043 at December 31, 2001. Net loans outstanding at September 30, 2002 also increased, but by \$16,372 or 9.8 percent, primarily as a result of a \$174 reduction in the allowance for loan losses during the first quarter of 2002. The improvement in gross loan volume was primarily related to material increases in the livestock, fruits, ornamentals, participations purchased and rural home loan industries.

Net loans at September 30, 2002 made up 95.9 percent of total assets, compared to 95.6 percent at December 31, 2001. At September 30, 2001 the percentage was 94.8 percent. The percentage increase during the past twelve months reflected the \$22,990 increase in net loan volume combined with reductions in other categories of assets.

As a percentage of gross loans, nonaccrual loans equaled 2.3 percent, compared with 2.5 percent and 3.7 percent at December 31, 2001 and September 30, 2001, respectively. The decrease in the percentage over the past twelve months was primarily the result of a partial payment received from the sale of collateral property related to a large volume account during the fourth quarter of 2001. 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 \$6,498 at September 30, 2002. The reduction of \$176 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 3.4 percent at September 30, 2002 and 3.9 percent at December 31, 2001. Net charge-offs during the first three quarters of 2002 were \$2, reflecting the improved credit quality and the secured nature of the Association's portfolio.

RESULTS OF OPERATIONS

Net income for the nine months ended September 30, 2002 totaled \$2,174 a decrease of \$660 or 23.3 percent compared to the same nine-month period of 2001.

Despite higher levels of accruing loan volume, from both LSA and participation operations, the significantly lower interest rate environment resulted in a reduction of \$1,180 in net interest income. This was partially offset by a positive increase in other operational areas of \$520.

Net interest income at September 30, 2002 was \$4,466 a decrease of \$1,180 or 20.9 percent from September 30, 2001 when net interest income was \$5,646. This decrease was primarily related to the lower interest rate environment, which resulted in a reduction of \$984 in interest expense credits earned from AgFirst Farm Credit Bank (the Bank). For the nine months ended September 30, 2002 interest credits earned were \$547 compared to the first nine months of 2001 when interest credits totaled \$1,531, a decrease of 64 percent. Additionally, during the first nine months of 2002 interest income recognized from the collection of nonaccrual loans decreased by \$125 when compared to the first nine months of 2001. Management continues to project lower levels of net interest income, as the most likely scenario for the remainder of 2002 has the interest rate environment at historically low levels.

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. There were no adjustments in the allowance for loan losses during the second and third quarters.

Noninterest income for the first nine months of 2002 totaled \$164 compared to \$195 for the first nine months of 2001. Primarily this was the result of a decrease of \$42 in miscellaneous income related to losses from prior years' activities.

Noninterest expense for the nine months ended September 30, 2002 was \$2,803 as compared to \$3,056 at September 30, 2001. The decrease was primarily related to the absence of \$532 in restructuring expense incurred during the first six months of 2001. Otherwise, noninterest expenses increased by \$279 in 2002 versus 2001, primarily due to increases in employee benefits, Farm Credit System Insurance Corporation premium payments and guarantee fees paid to the Bank.

During the first quarter of 2002, the Association recorded federal tax expense of \$21, \$15 related to the first quarter's estimated tax provision and \$6 related to the filing of the 2001 federal tax return. During the second and third quarters the Association recognized no estimated federal income tax expense. However, during September the Association received a signed agreement from the IRS related to an amended 2000 federal tax return. This resulted in the recording of a prior period adjustment for \$193 and a net tax benefit of \$173 for the first nine months of 2002. This compared to the first nine months of 2001 when the Association recognized a net tax benefit of \$49, mostly as a result of recording a prior period adjustment for \$153. The adjustment was recorded upon signing a closing agreement with the IRS related to an amended 1999 federal tax return.

Management projects that 2002's federal income tax expense will be an enhancement to final net income, exceeding the level achieved during 2001. As management continues to refine the holding company structure established during 2001, it is projected that the resultant federal tax liability and related provision expense for 2002 will be immaterial.

For the three months ended September 30, 2002.

Net income for the third quarter of 2002 was \$795 compared to \$915 for the third quarter of 2001. The primary factor in the decrease totaling \$120 was a decline in net interest income of \$195. The same as for the year-to-date, the lower interest rate environment negatively impacted the interest credit earned from the Bank.

Noninterest income for the quarter was \$49, an increase of \$2 over the same quarter of 2001. Noninterest expense for the three months ended September 30, 2002 totaled \$901, an increase of \$192 or 27.1 percent from the third quarter of 2001. The majority of the increase was related to salaries and employee benefits which increased by \$113.

During the third quarter of 2002 the Association recorded no provision for federal income tax. As previously

discussed, the Association recorded a prior period tax adjustment for \$193, resulting in a net tax benefit.

Key Results of Operations Ratios:

	Annualized for the nine months ended 9/30/02	For the year ended 12/31/01
Return on Average Assets	1.60%	2.18%
Return on Average Stockholders' Equity	6.33%	8.28%
Net Interest Income as a Percentage of Average Earning Assets	3.37%	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 September 30, 2002 was \$141,935 as compared with \$126,564 at December 31, 2001. The increase of \$15,371 or 12.1 percent very closely corresponded to the \$16,196 increase in gross loan volume during the first nine months of 2002.

The Association had no lines of credit outstanding with third parties as of September 30, 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 September 30, 2002 increased 4.6 percent to \$46,729 from December 31, 2001 when total stockholders' equity was \$44,686. The increase was primarily attributable to net income retained as unallocated surplus.

Total capital stock and participation certificates were \$997 on September 30, 2002 compared to \$974 on December 31, 2001. The net increase of \$23 was the result of new customers purchasing more stock than was refunded to borrowers who paid their loans in full.

Retained earnings unallocated increased \$2,020 or 4.6 percent from December 31, 2001 when unallocated retained earnings totaled \$43,712. The increase was net income retained in excess of equity dividends declared. The Association's directors declared cash dividends for the thirty-ninth consecutive quarter. The table below sets forth the amount of dividends declared:

<u>Quarter</u>	<u>Equity Based</u>	<u>Patronage Based</u>
Third 2002	\$50	
Second 2002	\$50	
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 September 30, 2002 was 27.21 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 nine months, as a result of higher gross loan volume. The Association's total surplus and core surplus ratios were both 26.56 percent at September 30, 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:

	9/30/02	12/31/01
Stockholders' Equity to Assets	24.53%	25.69%
Debt to Stockholders' Equity	3.08:1	2.89:1

IRS TAX SETTLEMENT

As previously disclosed in the 2000 Annual Report and updated in the 2001 Annual Report, Farm Credit 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. The Association received a signed agreement from the IRS during September of 2002. Thus, like 2001, the 2002 financial statements will reflect a net federal tax benefit enhancing net income.

Puerto Rico Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30,		December 31,
	2002	2001	2001
	<i>(unaudited)</i>		
Assets			
Cash	\$ 21	\$ 139	\$ 37
Loans	189,239	166,431	173,043
Less: allowance for loan losses	6,498	6,680	6,674
Net loans	182,741	159,751	166,369
Accrued interest receivable	1,064	1,462	1,026
Investment in AgFirst Farm Credit Bank	4,712	5,236	4,712
Premises and equipment, net	762	841	808
Other property owned	—	21	10
Other assets	1,221	989	1,005
Total assets	\$ 190,521	\$ 168,439	\$ 173,967
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 141,935	\$ 121,545	\$ 126,564
Accrued interest payable	192	299	154
Dividends payable	50	49	1,233
Other liabilities	1,615	1,462	1,330
Total liabilities	143,792	123,355	129,281
Commitments and contingencies			
Stockholders' Equity			
Capital stock and participation certificates	997	976	974
Retained earnings			
Unallocated	45,732	44,108	43,712
Total stockholders' equity	46,729	45,084	44,686
Total liabilities and stockholders' equity	\$ 190,521	\$ 168,439	\$ 173,967

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 September 30,		For the nine months ended September 30,	
	2002	2001	2002	2001
Interest Income				
Investment securities	\$ —	\$ —	\$ —	\$ 1
Loans	2,026	2,581	6,147	9,444
Total interest income	2,026	2,581	6,147	9,445
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	572	932	1,681	3,799
Net interest income	1,454	1,649	4,466	5,646
Provision for (reversal of) loan losses	—	—	(174)	—
Net interest income after provision for (reversal of) loan losses	1,454	1,649	4,640	5,646
Noninterest Income				
Loan fees	66	29	151	139
Fees for financially related services	4	5	11	12
Miscellaneous	(21)	13	2	44
Total noninterest income	49	47	164	195
Noninterest Expense				
Salaries and employee benefits	599	486	1,861	1,619
Occupancy and equipment	55	53	166	170
Insurance Fund premium	15	—	46	3
Guarantee fee	45	34	135	106
Other operating expenses	187	138	595	615
Restructuring charges	—	(4)	—	532
Losses on other property owned, net	—	2	—	11
Total noninterest expense	901	709	2,803	3,056
Income before income taxes	602	987	2,001	2,785
Provision (benefit) for income taxes	(193)	72	(173)	(49)
Net income	\$ 795	\$ 915	\$ 2,174	\$ 2,834

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	Total Stockholders' Equity
Balance at December 31, 2000	\$ 1,012	\$ 41,421	\$ 42,433
Net income		2,834	2,834
Capital stock/participation certificates issued	51		51
Capital stock/participation certificates retired	(87)		(87)
Cash dividends declared		(147)	(147)
Balance at September 30, 2001	<u>\$ 976</u>	<u>\$ 44,108</u>	<u>\$ 45,084</u>
Balance at December 31, 2001	\$ 974	\$ 43,712	\$ 44,686
Net income		2,174	2,174
Capital stock/participation certificates issued	90		90
Capital stock/participation certificates retired	(67)		(67)
Cash dividends declared		(149)	(149)
Dividend adjustment		(5)	(5)
Balance at September 30, 2002	<u>\$ 997</u>	<u>\$ 45,732</u>	<u>\$ 46,729</u>

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

Puerto Rico Farm Credit, ACA

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, 2001, are contained in the 2001 Annual Report to Stockholders. These unaudited third 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 owned or participated by the FLCA. This restructuring was accounted for as a reorganization of entities under common control similar to a pooling of interests.

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, continues to be subject to federal income tax. Refer to the "IRS Tax Settlement" section in the accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations for detail concerning refunds related to the tax exemption for long-term lending activity.

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 nine months ended September 30, 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 September 30, 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	—
Loans (charged off), net of recoveries	—
Balance at 9-30-01	<u>\$6,680</u>
Balance at 12-31-01	\$6,674
(Reversal of) provision for loan losses	(174)
Loans (charged off), net of recoveries	(2)
Balance at 9-30-02	<u>\$6,498</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.