PUERTO RICO FARM CREDIT, ACA

2007 ANNUAL REPORT

Contents

Management

William A. Garrahan..President and Chief Executive Officer
Sonia Arteaga..Vice President and Chief Credit Officer
Bruce M. Hoffman..Vice President and Chief Financial Officer/Treasurer

Board of Directors

Juan A. Santiago ....Chairman
Damián Rivera ....Vice Chairman
Felipe Ozonas-Morell ....Second Vice Chairman
Victor Ayala-Benitez ....Director
Francisco del Río ....Director
Carlos A. Rodríguez..Director
Francisco I. Sella..External Director
Antonio E. Marichal..External Director

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Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Puerto Rico Farm Credit, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2007 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

Juan A. Santiago
Chairman of the Board

William A. Garrahan
Chief Executive Officer

Antonio Marichal
Member of Board of Directors
Chairman of the Audit Committee

Bruce M. Hoffman
Chief Financial Officer

February 28, 2008

Consolidated Five - Year Summary of Selected Financial Data

(dollars in thousands)	2007	2006	December 31, 2005	2004	2003
Balance Sheet Data					
Cash	$ 130	$ 132	$ 27	$ 322	$ 316
Loans	250,019	247,136	277,468	250,495	223,321
Less: allowance for loan losses	330	271	237	198	5,983
Net loans	249,689	246,865	277,231	250,297	217,338
Investments in other Farm Credit institutions	3,399	3,670	2,864	2,712	4,712
Other property owned	73	—	150	150	—
Other assets	6,392	7,073	4,413	3,799	1,588
Total assets	$ 259,683	$ 257,740	$ 284,685	$ 257,280	$ 223,954
Notes payable to AgFirst Farm Credit Bank*	$ 197,926	$ 197,058	$ 225,635	$ 199,477	$ 172,971
Accrued interest payable and other liabilities with maturities of less than one year	4,767	4,787	4,257	3,242	3,716
Other liabilities with maturities of greater than one year	1,429	2,080	1,940	1,657	1,412
Total liabilities	204,122	203,925	231,832	204,376	178,099
Capital stock and participation certificates	819	874	940	998	1,022
Unallocated retained earnings	53,880	52,941	51,913	51,906	46,654
Accumulated other comprehensive income (loss)	862	—	—	—	(1,821)
Total members' equity	55,561	53,815	52,853	52,904	45,855
Total liabilities and members' equity	$ 259,683	$ 257,740	$ 284,685	$ 257,280	$ 223,954
Statement of Income Data					
Net interest income	$ 6,493	$ 6,327	$ 6,993	$ 6,532	$ 5,909
Provision for (reversal of allowance for) loan losses	59	34	—	(5,185)	(515)
Noninterest income (expense), net	(2,310)	(2,065)	(3,987)	(3,965)	(3,684)
Net income	$ 4,124	$ 4,228	$ 3,006	$ 7,752	$ 2,740
Key Financial Ratios					
Rate of return on average:					
Total assets	1.62%	1.62%	1.12%	3.22%	1.28%
Total members' equity	7.41%	7.73%	5.53%	16.38%	5.94%
Net interest income as a percentage of average earning assets	2.68%	2.53%	2.69%	2.76%	2.80%
Net chargeoffs (recoveries) to average loans	—	—	(0.015)%	0.25%	—
Total members' equity to total assets	21.40%	20.88%	18.57%	20.56%	20.48%
Debt to members' equity (:1)	3.67	3.79	4.39	3.86	3.88
Allowance for loan losses to loans	0.13%	0.11%	0.09%	0.08%	2.68%
Permanent capital ratio	23.48%	24.31%	24.02%	24.12%	25.85%
Total surplus ratio	23.11%	23.90%	23.59%	23.60%	25.26%
Core surplus ratio	23.11%	23.90%	23.59%	23.60%	25.26%
Net Income Distribution					
Cash dividends declared	$ —	$ —	$ 3,000	$ 2,500	$ 2,000
Estimated patronage refunds:					
Cash	$ 3,250	$ 3,200	$ —	$ —	$ —

* *General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2010.*

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Puerto Rico Farm Credit, ACA, (Association) for the year ended December 31, 2007 with comparisons to the years ended December 31, 2006 and December 31, 2005. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916, and has served agricultural producers for almost 90 years. The System's mission is to maintain and improve the income and well-being of farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members served (also referred to throughout this Annual Report as stockholders or shareholders). The territory served by the Association covers the entire island of Puerto Rico. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, ***www.agfirst.com,*** or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are on the Association's website, ***www.puertoricofarmcredit.com***, or may be obtained upon request free of charge by calling 1-800-981-3323, or writing Bruce M. Hoffman, Puerto Rico Farm Credit, ACA, PO Box 363649, San Juan, PR 00936. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Report to shareholders within 90 days after the end of the fiscal year. The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

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

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

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Significant accounting policies are critical to the understanding of the Association's results of operations and financial position because some accounting policies require the Board and management to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. These policies are critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant

Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

  Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

- *Pensions* — The Bank and its related associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. A discount rate is used to determine the present value of the future benefit obligations. The discount rate was selected by reference to Hewitt's, a global human resources service provider, corporate bond index, actuarial analyses and industry norms.

ECONOMIC CONDITIONS

During 2007, economic conditions were generally good for the Association's borrowers who continued to benefit from the relatively low interest rate environment. There has been significant change in the Association's loan portfolio over the past few years, with the Association buying and selling loan participations as well as the Association's involvement in Federal government guarantee programs. During 2007, the Association continued to target certain segments of the island's agricultural business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of the Association's services and streamline delivery of products to enhance the loan portfolio.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through various product types.

The gross loan volume of the Association as of December 31, 2007, was $250,019, an increase of $2,883 or 1.17 percent as compared to $247,136, at December 31, 2006 and compared to December 31, 2005 a decrease of $27,449 or 9.89 percent. Net loans outstanding (gross loans net of allowance for loan losses) on December 31, 2007 were $249,689 as compared to $246,865 at December 31, 2006 and $277,231 at December 31, 2005. Net loans accounted for 96.15 percent of total assets on December 31, 2007 as compared to 95.78 percent of total assets at December 31, 2006 and 97.38 percent of total assets at December 31, 2005.

The diversification of the Association's loan volume by type for each of the past three years is shown below.

Loan Type	12/31/07	12/31/06	12/31/05
Real estate mortgage	60.80%	58.04%	57.55%
Production and intermediate term	15.57	16.42	19.70
Agribusiness:			
Loans to cooperatives	–	.28	–
Processing and marketing	11.28	10.43	9.36
Farm related business	1.69	3.56	3.41
Communication	.52	.62	.47
Energy	.80	.80	–
Rural residential real estate	9.34	9.85	9.51
Total	100.00%	100.00%	100.00%

While the Association makes loans and provides financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, the loan portfolio is diversified. Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association's loan portfolio are shown below. The predominant commodities on the island are dairy, field crops, and livestock, which constitute 39.8 percent of the entire portfolio at December 31, 2007.

	Percent of Portfolio		
Commodity Group	**2007**	**2006**	**2005**
Participations (net)	31.7%	34.4%	30.3%
Dairy	21.0	20.8	26.8
Livestock (Beef Cattle)	10.6	8.9	7.4
Rural Home	9.4	10.0	9.7
Field Crops (Vegetables)	8.2	6.3	5.7
Fruits	5.9	6.5	8.3
Ornamentals/Nursery	3.1	3.1	2.4
Poultry	2.8	2.9	2.9
Plaintains	2.7	2.6	2.3
Coffee	1.7	1.7	1.4
Misc Real Estate	1.5	1.5	1.8
Horses	0.9	0.9	0.7
Other	0.6	0.5	0.2
Total	100.0%	100.0%	100.0%

Repayment ability is closely related to the commodities produced by the Association's borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of island dairy producers. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory. Even though the concentration of participation loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified, as well as the geographic risk. Management and the Board of Directors continue to believe the major factor protecting the balance sheet and income statement is diversification, spreading both geographic and industry concentration risks.

The decrease in gross loan volume for the twelve months ended December 31, 2006, was primarily attributable to the pay off of two large dairy loans totaling in excess of $21,000. Additionally, following objectives established by the Board of Directors in the 2006 Business Plan, the Association participated part of its chartered territory loan portfolio to the Bank. This action resulted in reductions in the gross loan portfolio of $7,971 and $8,962 at December 31, 2007 and December 31, 2006, respectively. The Association did not have any loans sold with recourse.

For the past few years, the Association has experienced a shift in loan assets. The long-term volume trend has been upward while the short and intermediate-term loan volume trend has been downward. This has been primarily the result of changes in the participation portfolio, which carries shorter maturities related to commercial lending activity. At December 31, 2007 and 2006, the Association had no one single borrower that comprised more than 10 percent of loan volume or interest income.

The Association has had increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which strengthens the Association's capital position. The following table presents information concerning the Association's participation purchased portfolio at December 31:

Loan Participations	**2007**	**2006**	**2005**
	(dollars in thousands)		
Participations Purchased – FCS Institutions	$ 59,448	$ 58,586	$ 53,933
Participations Purchased – Non-FCS Institutions	20,857	27,698	34,699
Participations Sold	–	–	(2,859)
Total	$ 80,305	$ 86,284	$ 85,773

Additionally, as part of the non-FCS participation portfolio, the Association purchased portions in loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing geographic risk and managing surplus funds as allowable under FCA regulations. At December 31, 2007 the balance of these loans (including unamortized premium) was $16,594 compared to $22,969 at December 31, 2006 and $29,934 at December 31, 2005.

MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot and the Tobacco Buyout Programs under the mission-related investments umbrella, as described below.

In October 2005, the FCA authorized AgFirst and the associations of the AgFirst District to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples includes investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2007, 2006 and 2005, the Association had $1,000, $0 and $0, respectively, in Rural America Bonds, and they are classified as Loans on the Consolidated Balance Sheets. The Association had no Loans or Investments under the Tobacco Buyout Program.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- *Character* – borrower integrity and credit history
- *Capacity* – repayment capacity of the borrower based on cash flows from operations or other sources of income
- *Collateral* – protection for the lender in the event of default and a potential secondary source of repayment
- *Capital* – ability of the operation to survive unanticipated risks
- *Conditions* – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate collateral. As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for real estate mortgage loans of more than $250,000. In addition, each loan is assigned a credit risk weighting based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

Management reviews the credit quality of the loan portfolio on an ongoing basis as part of the Association's risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- *Acceptable* – Assets are expected to be fully collectible and represent the highest quality.
- *Other Assets Especially Mentioned (OAEM)* – Assets are currently collectible but exhibit some potential weakness.
- *Substandard* – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- *Doubtful* – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- *Loss* – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	**2007**	**2006**	**2005**
Acceptable & OAEM	96.16%	98.89%	98.20%
Substandard	3.84	1.11	1.80
Doubtful	–	–	–
Loss	–	–	–
Total	100.00%	100.00%	100.00%

NONPERFORMING ASSETS

The Association's loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

	12/31/07	**12/31/06**	**12/31/05**
	(dollars in thousands)		
High-risk Assets			
Nonaccrual loans	$ 4,453	$ 2,029	$ 1,599
Restructured loans	–	–	–
Accruing loans 90 days past due	–	–	521
Total high-risk loans	4,453	2,029	2,120
Other property owned	73	–	150
Total high-risk assets	$ 4,526	$ 2,029	$ 2,270
Ratios			
Nonaccrual loans to total loans	1.78%	0.82%	0.58%
High-risk assets to total assets	1.74%	0.79%	0.80%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. Nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased $2,423 or 119.47 percent in 2007. Of the $4,453 in nonaccrual volume at December 31, 2007, $300 or 6.73 percent as compared to 4.93 percent and 14.26 percent at December 31, 2006 and 2005, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Allowance for Loan Losses

The allowance for loan losses at each period end has been considered by Association management to be adequate to absorb probable losses existing in and inherent to the loan portfolio. The allowance for loan losses was $330 at December 31, 2007, as compared with $271 and $237 at December 31, 2006 and 2005, respectively.

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Losses Activity:	2007	2006	2005
		(dollars in thousands)	
Balance at beginning of year	$ 271	$ 237	$ 198
Charge-offs:			
Production and intermediate term	$ –	$ –	$ –
Total charge-offs	–	–	–
Recoveries:			
Production and intermediate term	$ –	$ –	$ 39
Total recoveries	–	–	39
Net (charge-offs) recoveries	–	–	39
Provision for (reversal of allowance for) loan losses	$ 59	$ 34	$ –
Balance at end of year	$ 330	$ 271	$ 237
Ratio of net charge-offs during the period to average loans outstanding during the period	.000%	.000%	.015%

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31, 2007	2006	2005
		(dollars in thousands)	
Real estate mortgage	$ 137	$ 97	$ 94
Production and intermediate term	14	14	26
Agribusiness	152	134	101
Communication	6	5	–
Energy	4	4	–
Rural residential real estate	17	17	16
Total allowance	$ 330	$ 271	$ 237

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31, 2007	2006	2005
Total loans	.13%	.11%	.09%
Nonperforming loans	7.41%	13.36%	11.18%
Nonaccrual loans	7.41%	13.36%	14.82%

The financial position of the Association's borrowers has generally strengthened during the past decade as farmers' net cash income was at a favorable level due, in part, to steady increases in land values over the period and a lower interest rate environment. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of the loan portfolio has remained healthy. Please refer to Note 3, "Loans and Allowance for Loan Losses," in the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2007, totaled $4,124, a decrease of $104 or 2.46 percent, as compared to $4,228 for the same period of 2006 and for 2006, an increase of $1,222 or 40.65 percent, as compared to $3,006 for the same period of 2005. Interest income for the year ended December 31, 2007, was $18,397, an increase of $177 or .97 percent as compared to $18,220 for the same period of 2006. Interest income increased by $3,271 or 21.88 percent for the period ended December 31, 2006, compared to December 31, 2005. Major components of the change in net income for the past two years are outlined in the following table:

Change in Net Income:	2007-2006	2006-2005
	(dollars in thousands)	
Net income (prior year)	$ 4,228	$ 3,006
Increase (decrease) in net income due to:		
Interest income	177	3,271
Interest expense	(11)	(3,937)
Net interest income	166	(666)
Provision for loan losses	(25)	(34)
Noninterest income	(123)	1,947
Noninterest expense	(139)	(5)
Provision for income taxes	17	(20)
Total changes in income	(104)	1,222
Net income	$ 4,124	$ 4,228

Net Interest Income

Net interest income was $6,493, $6,327 and $6,993 in 2007, 2006 and 2005, respectively. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. Additionally, net interest income is negatively impacted by the amortization of premium paid to acquire loans in the secondary market place. Premium amortization expense was $483, $569 and $461 in 2007, 2006 and 2005, respectively. The effects of changes in average volume and interest rates on net interest income are summarized in the following table:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Other	Total
			(dollars in thousands)		
12/31/07 – 12/31/06					
Interest income	$ (557)	$ 748	$ (13)	$ (1)	$ 177
Interest expense	(490)	501	–	–	11
Income	$ (67)	$ 247	$ (13)	$ (1)	$ 166
12/31/06 – 12/31/05					
Interest income	$ (557)	$ 3,829	$ (6)	$ 5	$ 3,271
Interest expense	(342)	4,279	–	–	3,937
Income	$ (215)	$ (450)	$ (6)	$ 5	$ (666)

* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income.

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended December 31, 2007	2006	2005	Percentage Increase/(Decrease) 2007/2006	2006/2005
	(dollars in thousands)				
Loan fees	$ 319	$ 338	$ 322	(5.62)%	4.97%
Fees for financially related services	11	11	22	–	(50.00)
Patronage refunds from other Farm Credit Institutions	1,784	1,918	–	(6.97)	–
Other noninterest income	56	26	2	115.38	1,200
Total noninterest income	$ 2,170	$ 2,293	$ 346	(5.36)%	562.72%

Regarding patronage refunds received from Farm Credit Institutions, the Association received $1,519 in two patronage refunds and $265 in a special distribution from the Bank for the year ended December 31, 2007, this compared to $1,588 in patronage refunds and $330 in a special dividend for 2006. The Association did not receive either a patronage refund or a special dividend from AgFirst during 2005.

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended December 31, 2007	2006	2005	Percentage Increase/(Decrease) 2007/2006	2006/2005
	(dollars in thousands)				
Salaries and employee benefits	$ 2,926	$ 2,833	$ 2,877	3.28%	(1.53)%
Occupancy and equipment	264	272	240	(2.94)	13.33
Insurance Fund premiums	332	331	119	.30	178.15
Other operating expenses	958	905	1,100	8.00	(17.82)
Total noninterest expense	$ 4,480	$ 4,341	$ 4,336	3.23%	0.09%

Salaries and employee benefits expense increased in 2007 primarily due to higher costs associated with merit and incentive compensation offset by lower benefits expense related to pensions.

Income Taxes

The Association recorded no provision for federal income tax for the year ended December 31, 2007, as compared to a provision of $17 for 2006 and a $3 benefit for 2005. The Association is exempt from Puerto Rico income tax under Article 23 of the General Cooperative Act of 2004. Please refer to Note 2(H), "Income Taxes," in the Notes to the Consolidated Financial Statements for more specific information.

Key Results of Operations Comparisons

Key results of operations comparisons for the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/07	For the 12 Months Ended 12/31/06	For the 12 Months Ended 12/31/05
Return on Average Assets	1.62%	1.62%	1.12%
Return on Average Stockholders' Equity	7.41%	7.73%	5.53%
Net Interest Income as a Percentage of Average Earning Assets	2.68%	2.53%	2.69%
Net Chargeoffs (Recoveries) to Average Loans	–%	–%	(.015)%

The Association's financial goals continue to be the same as in previous years: operating within safe and sound parameters while generating sufficient income to maintain a highly capitalized Association and to declare and pay an attractive patronage dividend to the stockholders/borrowers of the Association. To accomplish this, the Association must achieve its objectives, which include attracting and retaining quality volume, which is competitively priced, while effectively managing risk within the balance sheet and income statement.

LIQUIDITY AND FUNDING SOURCES

Funding and Liquidity

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The Association's capital level effectively creates a borrowing margin between the amount of loans outstanding and the direct loans to the Bank. The margin is commonly referred to as "loanable funds."

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. The Association's liquidity practice is to maintain cash balances in a local depository bank at a level that maximizes reduction of the direct note by increasing loanable funds. As borrower payments are received, they are immediately applied to the respective note payable to the Bank. The Association's participation in investments and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in the Association experiencing a liquidity deficiency.

Total notes payable to the Bank at December 31, 2007 was $197,926 as compared to $197,058 at December 31, 2006 and $225,635 at December 31, 2005. The increase of .44 percent compared to December 31, 2006 and the decrease of 12.67 percent comparing December 31, 2006 to December 31, 2005, were both primarily the result of changes in loan volume. The average volume of notes payable to the Bank was $ 194,177 and $202,528 for the years ended December 31, 2007 and 2006, respectively. Refer to Note 6, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

The Association had no available lines of credit from third party financial institutions as of December 31, 2007.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed and variable rate loan products that are marginally 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). Fixed rate loans are priced based on the current cost of Farm Credit System debt of similar terms to maturity. The Association does not offer or include adjustable rate mortgages (ARMS) in its portfolio of loan products.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future loan growth and investment in new products and services, as they may become available.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan. There were no material changes to the capital plan for 2007 that affected the minimum stock purchase requirement or would have had an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2007 increased $1,746 or 3.24 percent from the December 31, 2006 total of $53,815. At December 31, 2006 total members' equity increased 1.82 percent to $53,815 from the December 31, 2005 total of $52,853. The increase each year was primarily related to the retention of net income from non-patronage sourced loans that was not eligible for patronage dividend consideration under the sub-chapter T cooperative federal tax filing status. Primarily, net income retained was earned by the Association's FLCA subsidiary, while the taxable net income of the ACA was distributed as a patronage dividend.

Additionally, for 2007, total members' equity increased by $862, which was the incremental adjustment recorded as Accumulated Other Comprehensive Income (Loss) from adopting the provisions of SFAS 158. The adoption of SFAS 158 had no effect on the Consolidated Statements of Income for the year ended December 31, 2007. Refer to Note 9, "Employee Benefit Plans," of the Notes to the Consolidated Financial Statements for additional information on the adoption of SFAS 158.

Total capital stock and participation certificates were $819 on December 31, 2007, compared to $874 on December 31, 2006 and $940 on December 31, 2005. The Board of Directors continued its commitment to maintain the cooperative equity investment requirement at the regulatory minimum of 2.0 percent of the original loan or $1,000, whichever is less.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standards for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2007	2006	2005	Regulatory Minimum
Permanent Capital	23.48%	24.31%	24.02%	7.00%
Total Surplus	23.11%	23.90%	23.59%	7.00%
Core Surplus	23.11%	23.90%	23.59%	3.50%

The decrease in the Association's permanent capital, total surplus and core surplus ratios as of December 31, 2007 was attributable to an increase in calculated risk weighted assets from December 31, 2006. There are no trends, commitments, contingencies or events that are likely to affect the Association's ability to meet the FCA's regulatory minimum capital standards and capital adequacy requirements.

See Note 7, "Members' Equity," of the Notes to the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, if necessary, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to participation loans purchased on a non-patronage basis, the remaining taxable earnings of the Association are eligible for allocation and distribution to eligible borrowers. Refer to Note 7, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distribution. The Association declared an estimated patronage distribution of $3,250 in 2007 and $3,200 in 2006.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young*, beginning** and small*** farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase its market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit.

The following table outlines the loan volume and number of YBS loans in the loan portfolio of the Association.

	As of December 31, 2007	
	Number of Loans	Amount of Loans
Young	122	$17,185
Beginning	395	$55,667
Small	525	$53,947

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2002 USDA (2002 is the latest USDA Ag census data available; next census will be available in 2008) Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory there were 16,675 reported farmers of which by definition 894 or 5.33 percent were Young, 5,478 or 32.68 percent were Beginning. The Puerto Rico census does not make available data which identifies and classifies small farmers. Comparatively, as of December 31, 2007, the demographics of the Association's agricultural portfolio contained 959 farmers, of which by definition 122 or 12.72 percent were Young, 395 or 41.19 percent were Beginning and 477 or 49.74 percent were Small.

In addition to the marketing strategies, in 2007 the Association supported young, beginning and small farmers through outreach and financial support programs.

Education is at the heart of the programs, and includes seminars, speaking opportunities and training sessions, which are conducted throughout the year. These educational opportunities may be both in-house, in the form of events held by the Association, and external, in which case, the Association is a speaker or provider of educational materials. The Association website includes a section of information and resources for YBS visitors to the site.

A second focus area of the program includes those activities where the Association sponsors local events or events where the Association is an exhibitor (such as industry or trade shows).

Financial support, addresses the specific credit programs and partnerships that the Association has developed to help small farmers, young farmers, and farmers just starting out. It comprises programs such as those offered by the Farm Service Agency (FSA), which includes guaranteed and direct loans to qualifying borrowers. The Association is a "certified lender," as designated by FSA.

The following outreach programs were conducted during 2007 in the Association's efforts to achieve established goals:

- utilization of AgScore (credit score lending for small loan borrowers)
- experienced credit staff coordinated/participated in the development and implementation of business financial skills training for YBS farmers
- supported and/or sponsored various programs and activities of 4H, the Service de Extension Agricola of UPR-Mayaguez.
- Participated in various educational programs coordinated by the Department of Agriculture.

The Marketing Manager coordinates the Association's efforts, and oversees the YBS program. The Association includes YBS goals in the annual strategic business plan, and reports on those goals and achievements to the board of directors on a quarterly basis.

The Association is committed to the future success of young, beginning and small farmers.

* *Young farmers* are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

** *Beginning farmers* are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

*** *Small farmers* are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than $250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and Puerto Rico income tax jurisdictions are 2004 and forward.

On September 29, 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*" The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. See Note 9, "Employee Benefit Plans," of the Notes to the Consolidated Financial Statements, for the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements.*" This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the Association's consolidated financial statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "*Fair Value Option for Financial Assets and Financial Liabilities.*" The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report.

Description of Property

The following table sets forth certain information regarding the property of the Association, which is located in San Juan, Puerto Rico:

Location	Description	Form of Ownership
213 Domenech Ave Hato Rey	Administrative/ San Juan Branch	Owned

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 10 and 12 of the Consolidated Financial Statements included in this Annual Report.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
William A. Garrahan	*President & Chief Executive Officer* since March 1992
Sonia C. Arteaga	*Vice President & Chief Credit Officer* since March 1992
Bruce M. Hoffman	*Vice President & Chief Financial Officer/Treasurer* since November 1992
Jorge A. Dulzaides	*Regional Lending Manager* since January 2000

The business experience for the past five years for the senior officers listed above has been with Puerto Rico Farm Credit, ACA.

The total amount of compensation earned by the CEO and the five most highly paid officers as a group, during the years ended December 31, 2007, 2006 and 2005, is as follows:

Aggregate Number of Senior Officers	Year	Salary	Exec. Compens.	Other Bonus	Total
William A. Garrahan	2007	$300,011	$100,000	$ 450	$400,461
William A. Garrahan	2006	$275,010	$ 43,750	$ 400	$319,160
William A. Garrahan	2005	$275,010	$ 50,000	$ 400	$325,410
5	2007	$561,843	$163,000	$2,250	$727,093
5	2006	$548,022	$ 79,000	$2,000	$629,022
5	2005	$718,028	$128,125	$2,000	$848,153

Regulatory reporting changes have affected the content of the above table. Compensation reported for 2007 and 2006 has changed; but, those changes are not reflected in the 2005 amounts. For all three years, the Association has had no plans in place or provisions which would allow for or facilitate the deferral of compensation, either salary or bonus.

Other bonus equates to the mandatory payment of a Christmas Bonus required by Commonwealth law. For all three years, the Board authorized payment of executive compensation in December of the year earned, as performance measures were finalized.

The Executive Compensation Plan (the Plan) is adopted annually for the current year. Actual payment is generally decided upon at the December board meeting, but can be any other date as the board decides, based upon whether performance measures are calculable and reportable. Compensation amounts are estimated, accrued and expensed on a monthly basis. The Plan not only covers the Association's senior officers, but also includes department managers. The objectives of the Plan are to tie management compensation directly to organizational performance, focusing attention on both short-term and long-term results. For the three years covered in this report, the Board adopted plans which contained quantifiable performance categories. For 2007, 2006, and 2005, the Board of Directors adopted plans which contained the same quantifiable categories, and included a fourth discretionary category that was not quantifiably measurable. Each performance area has a defined payout amount assigned with measurable performance targets established.

The following chart describes the weighted significance each performance category was assigned by the Board of Directors during the last three years.

	2005	2006	2007
Business loan volume	35%	25%	25%
Quality control	20%	15%	5%
Financial performance	20%	15%	5%
Individual contribution	25%	45%	65%

Within each major performance category there were specific objectives established which were designed to motivate performance that exceeded the most likely goals of the related annual business plan. These objectives typically include return on assets, credit quality, delinquency, growth in loan volume, examination results and control of operating expenses.

Disclosure of information on the total compensation paid during 2007 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business.

A copy of the policy is available to stockholders of the Association upon request.

The aggregate amount of expense or reimbursement for travel, subsistence and other related expenses for all directors as a group was $58,892 for 2007, $44,086 for 2006, and $40,598 for 2005.

Subject to approval of the Board of Directors, the chairman was compensated at a per diem rate of $400 for all official activities. The other five elected, stockholder directors were compensated at a per diem rate of $375. Honorarium for each of the two independent, outside directors was at a per diem rate of $1,000 for all official activities. Directors are also paid honorarium at the per diem rate on a full day basis for normal travel to and from conferences and meetings when the distance and schedule requires travel on any portion of the day prior to or following the scheduled activity.

In addition, all directors were paid quarterly a retainer fee as compensation for incidental services and review/preparation for meetings and assignments. The chairman's retainer fee was $875 per quarter and $750 per quarter for all other directors, including the two outside directors.

Additional information for each Director is provided below:

Name of Director	No. of Days Served: Regular Board Meetings	No. of Days Served: Other Official Activities	Committee Assignments	Total Honoraria During 2007
Juan A. Santiago	12	13	Governance/Compensation	$ 13,500
Damián Rivera	11	9	Governance - Chairman	10,500
Felipe Ozonas-Morell	10	4	Governance Compensation - Chairman	8,625
Francisco del Río	12	9	Credit Review	10,875
Carlos A. Rodríguez	12	9	Credit Review	10,875
Víctor M. Ayala	12	10	Audit	11,250
Francisco I. Sella	10	10	Audit	23,000
Antonio Marichal *	12	10	Audit - Chairman Compensation	25,000
				$ 113,625

** Audit Committee financial expert as determined by the Board of Directors.*

All directors shall make themselves available to serve on the loan committee, upon the scheduling of a meeting. Any two directors along with the president/CEO shall constitute a quorum for the loan committee. Committee meetings are normally scheduled and held the same day as monthly board of director's meetings. This scheduling results in there being no separate and/or additional honorarium paid for the committee meeting.

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years:

Mr. Juan A. Santiago, 43, Chairman, owns and operates a 240-acre floriculture, plantain and beef cattle farm. Mr. Santiago is an agronomist and is a member of the Puerto Rico Farm Bureau Association, the Puerto Rico Agronomist Association, the Audubon Society and the Ornamental Plants Producers Association. His term of office is 2007 – 2010.

Mr. Damián Rivera, 54, Vice Chairman, owns and operates a 414-acre coffee, plantains and dairy herd replacement farm. He is an agronomist and is a member of the Puerto Rico Agronomist Association. His term of office is 2006 – 2009.

Mr. Francisco del Río, 59, is a producer of hay, hogs and sileage on his farm in barrio San Lorenzo, Morovis. He is a member of the Puerto Rico Farm Bureau Association. His term of office is 2007 – 2010.

Mr. Felipe Ozonas-Morell, 46, owns and operates a farm in Castañer, Adjuntas, producing Arábiga and Robusta coffee and production, packing and marketing of Valencia and mandarin oranges. He completed advanced studies in livestock engineering in Spain and is a member of the Puerto Rico Farm Bureau. His term of office is 2006 – 2009.

Mr. Victor M. Ayala, 59, owns and operates a dairy farm in Humacao. He attended University of Puerto Rico – Mayaguez Campus, where he obtained a degree in Civil Engineering. His memberships include College of Engineers and Surveyors, Puerto Rico Farm Bureau, Asociación Pecuaria del Este, Federación de Asociaciones Pecuarias de PR, Inc. and Fondo de Estabilización de Precios de la Industria Lechera. His term of office is 2007 – 2008.

Mr. Carlos A. Rodríguez, 57, owns and operates a dairy farm in Morovis. He has a bachelor's degree in Business Administration from the University of Puerto Rico. His memberships include the Puerto Rico Farm Bureau, board member of the "Junta Fondo Estabilización de Precios de la Industria Lechera" and Puerto Rico Dairy Herd Improvement Association. His term of office is 2005 – 2008.

Mr. Francisco I. Sella, 74, External Director, is an agronomist and has occupied different positions related to agriculture and non-agricultural industries. His memberships include President of Ponce Chapter of "Colegio de Agrónomos," Member of "Club de Rotarios," President Caribbean District of "Soil Conservation." His term of office is 2006 – 2009.

Mr. Antonio E. Marichal, 57, External Director, is an accountant and licensed attorney. For the past five years he has been a partner in a law firm, specializing in corporate law. He is very familiar with agriculture, especially the dairy sector. His memberships include Puerto Rico Bar Association, American Bar Association, Asociación de Notarios de PR, among others. His term of office will be 2006 – 2009.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 11 of the Consolidated Financial Statements, "Related Party Transactions," included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

Transactions Other Than Loans

No director or senior officer have held or hold preferred stock issued by the Association. At December 31, 2007 the Association had not issued and did not have any preferred stock outstanding.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Relationship with Independent Auditors and Other Qualified Public Accountants

There were no changes in or material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

Aggregate fees expensed by the Association for services rendered by its independent auditor and other qualified public accountants for the year ended December 31, 2007 were as follows:

	2007
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	$ 52,800
Qualified Public Accountant	
Harper, Rains, Knight & Company	
Nonaudit services	55,775
Other	4,225
Qualified Public Accountant	
KPMG, LLP	
Tax services	54,720
Total	$ 167,520

Audit service fees were for the annual audit of the consolidated financial statements.

Nonaudit service fees were for the annual Sox and internal operational reviews.

Other fees were for services rendered in connection with a cost allocation study involving the Association's organizational structure.

All nonaudit service fees incurred by the Association were approved by the Audit Committee.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2008 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association's Annual and Quarterly reports are available upon request free of charge by calling 1-787-753-5435, or writing Bruce M. Hoffman, Vice President, Puerto Rico Farm Credit, ACA, PO Box 363649, San Juan, PR 00936 or accessing the web site, ***www.puertoricofarmcredit.com***. The Association prepares an electronic version of the Annual Report which is available on the Association's web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management's Discussion and Analysis of Financial Condition and Results of Operations section included in this Annual Report to the shareholders.

Shareholder Investment

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at ***www.agfirst.com***. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Puerto Rico Farm Credit, ACA (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2007, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication with those charged with Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees*)*, and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

The members of the Committee are not professionally engaged in the practice of auditing or accounting. The members of the Committee rely, without independent verification, on the information provided to them and on the representations made by management and the independent auditors. Accordingly, the Committee's considerations and discussions referred to above do not assure that the audit of the Association's financial statements has been carried out in accordance with auditing standards generally accepted in the United States of America or that the financial statements are presented in accordance with accounting principles generally accepted in the United States of America.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2007. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:

Antonio E. Marichal, External Director
Chairman of the Audit Committee

Members of Audit Committee

Víctor M. Ayala, Director
Francisco I. Sella, External Director

February 28, 2008

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
Telephone (678) 419 1000

Report of Independent Auditors

To the Board of Directors and Members
of Puerto Rico Farm Credit, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Puerto Rico Farm Credit, ACA (the Association) and its subsidiaries at December 31, 2007, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2008

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2007	December 31, 2006	December 31, 2005
Assets			
Cash	$ 130	$ 132	$ 27
Loans	250,019	247,136	277,468
Less: allowance for loan losses	330	271	237
Net loans	249,689	246,865	277,231
Accrued interest receivable	1,783	1,907	1,687
Investments in other Farm Credit institutions	3,399	3,670	2,864
Premises and equipment, net	976	792	482
Other property owned	73	—	150
Due from AgFirst Farm Credit Bank	1,784	1,919	—
Other assets	1,849	2,455	2,244
Total assets	$ 259,683	$ 257,740	$ 284,685
Liabilities			
Notes payable to AgFirst Farm Credit Bank	$ 197,926	$ 197,058	$ 225,635
Accrued interest payable	958	1,014	890
Patronage refund or dividends payable	3,250	3,200	3,000
Other liabilities	1,988	2,653	2,307
Total liabilities	204,122	203,925	231,832
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	819	874	940
Unallocated retained earnings	53,880	52,941	51,913
Accumulated other comprehensive income (loss)	862	—	—
Total members' equity	55,561	53,815	52,853
Total liabilities and members' equity	$ 259,683	$ 257,740	$ 284,685

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2007	2006	2005
Interest Income			
Investment securities	$ 7	$ 8	$ 4
Loans	18,390	18,212	14,945
Total interest income	18,397	18,220	14,949
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	11,904	11,893	7,956
Net interest income	6,493	6,327	6,993
Provision for (reversal of allowance for) loan losses	59	34	—
Net interest income after provision for (reversal of allowance for) loan losses	6,434	6,293	6,993
Noninterest Income			
Loan fees	319	338	322
Fees for financially related services	11	11	22
Patronage refunds from other Farm Credit institutions	1,784	1,918	—
Other noninterest income	56	26	2
Total noninterest income	2,170	2,293	346
Noninterest Expense			
Salaries and employee benefits	2,926	2,833	2,877
Occupancy and equipment	264	272	240
Insurance Fund premiums	332	331	119
Guarantee fee	—	16	186
Other operating expenses	958	887	910
Other noninterest expense	—	2	4
Total noninterest expense	4,480	4,341	4,336
Income before income taxes	4,124	4,245	3,003
Provision (benefit) for income taxes	—	17	(3)
Net income	$ 4,124	$ 4,228	$ 3,006

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Capital Stock and Participation Certificates	Unallocated	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2004	$ 998	$ 51,906	$ —	$ 52,904
Net income		3,006		3,006
Capital stock/participation certificates issued/(retired), net	(58)			(58)
Cash dividends declared		(3,000)		(3,000)
Patronage distribution adjustment		1		1
Balance at December 31, 2005	940	51,913	—	52,853
Net income		4,228		4,228
Capital stock/participation certificates issued/(retired), net	(66)			(66)
Patronage distribution declared				
Cash		(3,200)		(3,200)
Balance at December 31, 2006	874	52,941	—	53,815
Net income		4,124		4,124
Capital stock/participation certificates issued/(retired), net	(55)			(55)
Patronage distribution declared				
Cash		(3,250)		(3,250)
Patronage distribution adjustment		65		65
Adjustment to initially apply FAS No. 158			862	862
Balance at December 31, 2007	$ 819	$ 53,880	$ 862	$ 55,561

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2007	2006	2005
Cash flows from operating activities:			
Net income	$ 4,124	$ 4,228	$ 3,006
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	164	166	163
Amortization of premiums on purchased loans	483	569	461
Provision for (reversal of allowance for) loan losses	59	34	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	124	(220)	(425)
(Increase) decrease in due from AgFirst Farm Credit Bank	135	(1,919)	—
(Increase) decrease in other assets	606	(211)	(146)
Increase (decrease) in accrued interest payable	(56)	124	451
Increase (decrease) in other liabilities	197	351	347
Total adjustments	1,712	(1,106)	851
Net cash provided by (used in) operating activities	5,836	3,122	3,857
Cash flows from investing activities:			
Net (increase) decrease in loans	(3,528)	29,763	(27,395)
(Increase) decrease in investment in other Farm Credit institutions	271	(806)	(152)
Purchases of premises and equipment	(348)	(476)	(206)
Proceeds from sales of other property owned	89	145	—
Net cash provided by (used in) investing activities	(3,516)	28,626	(27,753)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	868	(28,577)	26,158
Capital stock and participation certificates issued/(retired), net	(55)	(66)	(58)
Patronage refunds paid	(3,135)	—	—
Cash dividends paid	—	(3,000)	(2,499)
Net cash provided by (used in) financing activities	(2,322)	(31,643)	23,601
Net increase (decrease) in cash	(2)	105	(295)
Cash, beginning of period	132	27	322
Cash, end of period	$ 130	$ 132	$ 27
Supplemental schedule of non-cash activities:			
Loans transferred to other property owned	$ 162	$ —	$ —
Cash dividends or patronage distributions declared	3,250	3,200	3,000
Decrease in liability resulting from adoption of FAS 158	(862)	—	—
Supplemental information:			
Interest paid	$ 11,960	$ 11,769	$ 7,505
Taxes paid, net	—	2	—

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Puerto Rico Farm Credit, ACA (Association) is a stockholder-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes within the Commonwealth of Puerto Rico. The Association is also authorized by its charter from the Farm Credit Administration to provide the same credit and credit-related services for qualified purposes within the territory of the U.S. Virgin Islands.

The Association is a lending institution of the Farm Credit System (the System) a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2007, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-four Associations.

AgFirst Farm Credit Bank (Bank) and its related associations are collectively referred to as the "District." The Bank provides funding to associations within the District and is responsible for supervising certain activities of the Association, as well as the other associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which are structured as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

Puerto Rico Farm Credit, ACA holds a charter for each of the two wholly-owned subsidiaries. The Association makes short- and intermediate-term loans for agricultural production or operating purposes, and collateralized long-term real estate mortgage loans, with funding from the Bank. The ACA further participates certain participation loans acquired on a non-patronage basis to the FLCA.

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on net income or total stockholders' equity of prior years. The Consolidated Financial Statements include the accounts of Puerto Rico Farm Credit, FLCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash as included in the statements of cash flows, represents cash on hand and on deposit at the Association's depository bank.

B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans for agricultural purposes generally have maturities that extend up to 20 years. Long-term real estate loans made for the purpose of rural housing may have original maturities that range from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans originated within the Association's chartered territory, Puerto Rico, are generally carried at the principal amount outstanding, net of the unamortized cost to originate. The related loan origination fees and direct loan origination costs are netted and deferred and the net fee or cost is amortized over the life of the related loan as an adjustment to yield. Certain participation loans are purchased at a premium. These loans are carried at the principal amount outstanding, plus the unamortized premium. Premium is amortized on a monthly basis as an adjustment to interest income. Additionally, some of the participation loans purchased at a premium are acquired in the USDA secondary market with both the principal and the interest unconditionally guaranteed by the United States government. Interest on loans, both originated and purchased participations, is accrued and credited to interest income based upon the daily principal amount outstanding

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

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

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

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

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

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

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

C. **Investment in AgFirst Farm Credit Bank:** The Association is required to maintain ownership in the Bank. Such ownership investment in the Bank is in the form of Class C stock. This investment may be adjusted periodically. Accounting for this investment is on the purchased cost basis.

D. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates of the fair value less costs to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income expenses and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.

E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.

F. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured.

G. **Employee Benefit Plans:** Substantially all employees of the Association may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and is considered a multi-employer plan. The Plan is noncontributory and includes eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes and for funding purposes. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula. The cost of the Plan is allocated based on a percentage of each institution's salary expense to the total salary expense for all Plan participants.

Substantially all employees of the Association may also be eligible to participate in the District's thrift plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. The Thrift Plan also qualifies in Puerto Rico with the Department of the Treasury (Hacienda) as an 1165(e) plan. For employees hired on or prior to December 31, 2002, the Association contributes $.50 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes $1.00 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. Employee contributions are not to exceed the maximum contribution as established by Hacienda. On a monthly basis Thrift Plan administrative costs are accrued and/or expensed when incurred, depending upon the individual vendor providing services.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.

The Association provides certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. Refer to Note 9, "Employee Benefit Plans," for the impact of the adoption of FAS 158, and for more detail on costs directly related to employee benefit plans.

H. **Income Taxes:** Prior to 2006, the Association filed the federal tax return under Section 936 of the Internal Revenue Code. Under Section 936, the Association utilized a wage-based credit to offset federal income tax computed on Puerto Rico sourced income.

In 1996, Congress amended Section 936 to repeal the Puerto Rico and possessions tax credit for taxable years beginning after December 31, 1995. However, a newly created Section 30(A) provided an economic activity credit for Puerto Rico. As signed into law, Section 30(A) contained a ten-year phase-out period. Furthermore, Section 30(A) imposed a cap on corporate possession business income eligible for wage tax credits beginning in 2002. For 2005, the provisions of Section 30(A) did not subject the Association's possession sourced income to additional taxation.

Beginning in 2006, the Association elected to operate as a cooperative that qualifies for federal tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the ACA can exclude from taxable income amounts distributed as qualified patronage refunds. Provisions for federal income tax will be calculated and recorded only on those earnings not distributed. The Association distributes 100 percent of patronage sourced earnings on the basis of federal taxable income.

As previously described, the ACA operates with one wholly-owned subsidiary. The FLCA is exempt from federal and other income taxes as provided in the Farm Credit Act. The ACA is subject to federal income tax. The Association accounts for income taxes under the asset and liability method. Deferred taxes were recognized prior to 2006 for estimated taxes ultimately payable or recoverable based upon enacted federal law at the ACA's estimated effective federal rate.

The Association has adopted a "pro-rata" method to tax effect only the portion of the Association's temporary differences expected to have a future tax consequence to the Association. As the Association intends to only have patronage sourced income, that will be distributed in its entirety on a cooperative basis as tax deductible patronage dividends, this operating scenario results in zero federal taxable income. Thus, the Association has applied a zero effective tax rate to its cumulative temporary differences, effective January 1, 2006.

For Puerto Rico tax purposes, the Association has had a ruling from the Puerto Rico Treasury Department since June 1993 determining that the Association and its subsidiaries will be treated as a domestic cooperative association. Thus, the Association enjoys the exemptions provided by Article 23 of the General Cooperative Association Act of Puerto Rico of 2004, Act No. 239 of September 1, 2004.

I. **Patronage Refund from AgFirst:** The Association records patronage refunds from the Bank on an accrual basis.

J. **Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109"* (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and Puerto Rico income tax jurisdictions are 2004 and forward.

On September 29, 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*." The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. See Note 9, "Employee Benefit Plans," for the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, *"Fair Value Measurements."* This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the Association's Consolidated Financial Statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "*Fair Value Option for Financial Assets and Financial Liabilities."* The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

Note 3 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2007	2006	2005
Real estate mortgage	$ 152,002	$ 143,302	$ 159,698
Production and intermediate term	38,918	40,586	54,658
Loans to cooperatives	–	684	–
Processing and marketing	28,202	25,804	25,962
Farm related business	4,235	8,830	9,451
Communication	1,303	1,527	1,312
Energy	2,000	2,000	–
Rural residential real estate	23,359	24,403	26,387
Total loans	$ 250,019	$ 247,136	$ 277,468

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

Total loans at December 31, 2007, 2006 and 2005 consisted of the following commodity types:

Commodity Type	December 31, 2007	2006	2005
Participations Purchased	32%	34%	30%
Dairy	21	21	27
Livestock	11	9	7
Rural Home	9	10	10
Field Crops	8	6	6
Fruit	6	7	8
Ornamentals	3	3	2
Plantains	3	3	2
Poultry	3	3	3
Coffee	2	2	1
Miscellaneous Real Estate	1	2	2
Other Ag-Purpose	1	–	2
Total	100%	100%	100%

At December 31, 2007, the Association had no one single borrower that comprised more than 10 percent of loan volume or interest income.

The FCA has in place regulations which limit the total amount of principal and commitment a direct lender association may make available to an individual loan relationship. The regulatory limit is 25 percent of permanent capital. In response to these regulations, the Association and the Bank entered into an agreement which permitted the Association to sell and the Bank to purchase the potential loan loss risk in an individual loan relationship in excess of the Association's administratively established lending limit. The Bank purchased such risk in consideration of the Association's payment of a guarantee fee. The Association paid guarantee fees totaling $16 in 2006 and $186 in 2005.

Effective January 1, 2006, the Association and the Bank agreed to revise the method used to handle such loans. Instead of paying a monthly fee, the Association participates (sells to the Bank) the excess volume above the Association's administratively established lending limit. At December 31, 2007 and 2006, the Association had sold to the Bank $7,971 and $8,962, respectively, from one lending relationship.

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

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

The following table presents information relating to impaired loans.

	December 31, 2007	2006	2005
Nonaccrual loans:			
Current as to principal and interest	$ 300	$ 100	$ 228
Past due	4,153	1,929	1,371
Total nonaccrual loans	4,453	2,029	1,599
Impaired accrual loans:			
Restructured accrual loans	–	–	–
Accrual loans 90 days or more past due	–	–	537
Total impaired accrual loans	–	–	537
Total impaired loans	$ 4,453	$ 2,029	$ 2,136

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2007.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31, 2007	2006	2005
Interest income recognized on nonaccrual loans	$ 76	$ 88	$ 94
Interest income on impaired accrual loans	17	47	4
Interest income recognized on impaired loans	$ 93	$ 135	$ 98

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

	2007	2006	2005
Impaired loans with related allowance	$ –	$ –	$ –
Impaired loans with no related allowance	4,453	2,029	2,136
Total impaired loans	$ 4,453	$ 2,029	$ 2,136
Allowance on impaired loans	$ –	$ –	$ –

The following table summarizes impaired loan information for the year ended December 31,

	2007	2006	2005
Average impaired loans	$ 3,026	$ 2,769	$ 2,065

Life-to-date interest income on nonaccrual loans that would have been recognized under the original terms of the loans, totaled $786 at December 31, 2007, $630 at December 31, 2006, and $504 at December 31, 2005. The following table presents information concerning nonaccrual loans for 2007, 2006 and 2005:

	Year Ended December 31, 2007	2006	2005
Interest income which would have been recognized under the original loan terms	$ 245	$ 170	$ 166
Interest income compromised during collection	35	4	804
Less: interest income recognized and collected	(76)	(88)	(94)
Foregone interest income	$ 204	$ 86	$ 876

The changes in the allowance for loan losses are as follows:

	Year Ended December 31, 2007	2006	2005
Balance at beginning of year	$ 271	$ 237	$ 198
Charge-offs:			
Production and intermediate term	–	–	–
Total charge-offs	–	–	–
Recoveries:			
Production and intermediate term	–	–	39
Total recoveries	–	–	39
Net (charge-offs) recoveries	–	–	39
Provision for (reversal of allowance for) loan losses	59	34	–
Balance at end of year	$ 330	$ 271	$ 237
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	0.000%	0.000%	0.015%

In addition, the following is a breakdown of the allowance for loan losses at the end of the last three fiscal years:

	December 31, 2007		December 31, 2006	
	Amount	%	Amount	%
Real estate mortgage	$ 137	42%	$ 97	36%
Production and intermediate term	14	4	14	5
Agribusiness	152	46	134	50
Communication	6	2	5	2
Energy	4	1	4	1
Rural residential real estate	17	5	17	6
Total	$ 330	100%	$ 271	100%

	December 31, 2005	
	Amount	%
Real estate mortgage	$ 94	40%
Production and intermediate term	26	11
Agribusiness	101	42
Communication	–	–
Energy	–	–
Rural residential real estate	16	7
Total	$ 237	100%

Note 4 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in AgFirst Farm Credit Bank of Class C stock. The Bank may require additional capital contributions to maintain its capital requirements.

At December 31, 2007, the Association's investment in the Bank was composed of purchased Class C stock and totaled $3,399. At December 31, 2006 and 2005, the Association's investment in the Bank was also composed of purchased Class C stock from AgFirst and totaled $3,670 and $2,864, respectively. In 2007, the Association received a refund of Bank stock totaling $271, and in 2006 and 2005 the Association purchased additional stock totaling $806 and $152, respectively, as part of the Bank's annual capital equalization program.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2007	2006	2005
Land and improvements	$ 106	$ 106	$ 75
Buildings and improvements	1,254	1,099	833
Furniture and equipment	1,123	1,134	1,217
	2,483	2,339	2,125
Less: accumulated depreciation	1,507	1,547	1,643
Total	$ 976	$ 792	$ 482

Note 6 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives.

The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 5.81 percent for LIBOR-based loans, 5.75 percent for Prime-based loans, and the weighted average remaining maturities were 5.9 years and 8.1 years, respectively, at December 31, 2007. The weighted average interest rate on the fixed rate notes payable which are match funded by the Bank was 5.52 percent and the weighted average remaining maturity was 5.4 years at December 31, 2007. The weighted average interest rate on all interest-bearing notes payable was 5.68 percent and the weighted average remaining maturity was 7.0 years at December 31, 2007.

Variable rate and fixed rate notes payable represent approximately 58.10 percent and 41.90 percent, respectively, of total notes payable at December 31, 2007.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors and formulas relating primarily to credit quality and financial condition. At December 31, 2007, the Association's notes payable were within the specified limitations.

Note 7 — Members' Equity

A description of the Association's capitalization requirements, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or Class C participation certificates in the case of rural home and farm related business loans, as a condition of borrowing.

The initial borrower investment, through either purchase or transfer, must be in an amount equal 2.0 percent or $1, whichever is less. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs.

Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation. At December 31, 2007, the Association had no loans designated for sale, nor were any loans previously sold into the Secondary Market.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock and participation certificates owned by all borrowers.

Retirement of such equities is at par ($5 per share). Repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates. Retirements of equity investments are subject to approval by the Board, at its sole discretion. Subject to any limitations of the Farm Credit Act, when the debt of a borrower/stockholder is in default, the Association may order retirement of stock or participation certificates owned by the borrower and apply the proceeds to the indebtedness.

B. **Regulatory Capitalization Requirements and Restrictions**

FCA's capital adequacy regulations require the Association to maintain permanent capital of 7.0 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the 7.0 percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements.

The Association is prohibited from reducing permanent capital by retiring equity or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of 7.0 percent and core surplus as a percentage of risk-adjusted assets of 3.5 percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2007 were 23.48 percent, 23.11 percent and 23.11 percent, respectively.

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

C. **Description of Equities**

The Association is authorized to issue or have outstanding Class D Preferred Stock, Classes A and C Common Stock, Class C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All classes of stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The Association had the following shares outstanding at December 31, 2007:

		Shares Outstanding	
Class	**Protected**	**Number**	**Aggregate Par Value**
C Common/Voting	No	102,860	$ 514
C Participation Certificates/Nonvoting	No	60,924	305
Total Capital Stock and Participation Certificates		163,784	$ 819

Common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amount, provided the minimum capital adequacy standards established by the Board are met.

Retained Earnings

The Association maintains an unallocated retained earnings account. The minimum amount is determined annually by the Board. At the end of any fiscal year, if the retained earnings account would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings from the current year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board.

Equity Dividends

Equity dividends may be declared and paid on stock and participation certificates as determined by the Board's resolution. The rate of dividend paid on Class D Preferred Stock for any fiscal year may not be less than the rate of dividend paid on common stock or participation certificates for such year. All equity dividends shall be paid on a per share basis. Dividends on common stock and participation certificates shall be noncumulative without preference between classes.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. During 2005, the Board declared a year-end equity dividend calculated on a patronage basis. The Board declared that the dividend would be paid based upon a proportionate basis using the percentage of net interest margin each lending group contributed toward the Association's total net interest margin.

Patronage Dividends

The Board, by adoption of a resolution, may obligate the Association to distribute to eligible borrowers on a patronage basis all or any portion of available net earnings for the fiscal year. For 2007 and 2006, by adoption of resolutions in December 2006 and 2005, the Board obligated the Association to distribute to eligible borrowers on a patronage basis all or any portion of available net taxable earnings. The 2006 patronage distribution was paid 100 percent in cash, based on the proportion of each eligible borrower's net interest margin as compared to the total net interest margin earned by all eligible borrowers. The 2007 patronage distribution will be paid on the same basis. The Board of Directors reserves the right to change the basis for the payment of patronage dividends in future years.

If the Association meets its capital adequacy standards after accruing the patronage distribution, the dividend distribution may be paid in cash, authorized stock of the Association, allocations of earnings retained in an allocated member's equity account, or any one or more of such forms of distribution. The Board determined that 100 percent of the 2007 and the 2006 patronage dividends would be paid in cash by check.

Transfer

Each owner or joint owners of Class C Common Stock is entitled to a single vote, regardless of the number of shares owned, while Class A Common Stock, Class D Preferred Stock and Class C Participation Certificates provide no voting rights to their owners. Voting stock may not be transferred to another person unless such person is eligible to hold voting stock. Common stock and participation certificates may be transferred to any person eligible to hold such class of equity under the bylaws. Class D Preferred Stock may be transferred in the manner set forth in the resolution authorizing its issuance.

Impairment

Under the capitalization bylaw of the Association, all stock and participation certificates are considered to be issued "at risk" and are not protected under the Farm Credit Act. Any net losses recorded by the Association shall first be applied against unallocated retained earnings. To the extent that such losses would exceed unallocated retained earnings, resulting in impairment of the Association's capital stock, such losses would be applied pro rata to each share and/or unit outstanding in the class, in the following order:

1. Classes A and C Common Stock and Class C Participation Certificates
2. Class D Preferred Stock

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities would be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Class D Preferred Stock
2. Classes A and C Common Stock and Participation Certificates

D. **Accumulated Other Comprehensive Income (Loss)**

The Association reports accumulated other comprehensive income (loss) (OCI) in its Consolidated Statement of Changes in Members' Equity. The Association recognized OCI of $862 in 2007 upon adopting FAS 158. Refer to Note 9, "Employee Benefit Plans," for further information.

Note 8 — Income Taxes

The provision (benefit) for federal income taxes follows:

	Year Ended December 31, 2007	2006	2005
Current:			
Federal	$ –	$ 2	$ –
Deferred:			
Federal	–	10	(3)
Federal tax write-off	–	5	–
	–	15	(3)
Total provision (benefit) for income taxes	$ –	$ 17	$ (3)

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31, 2007	2006	2005
Federal tax at statutory rate	$ 1,402	$ 1,443	$ 1,023
Impact of future tax credits	–	–	(144)
Possessions credit	–	–	(594)
Patronage distributions	(816)	(845)	–
Tax-exempt FLCA earnings	(570)	(576)	(305)
Other	(16)	(5)	17
Provision (benefit) for income taxes	$ –	$ 17	$ (3)

Deferred tax assets and liabilities result from the following at:

	December 31, 2007	2006	2005
Deferred income tax assets:			
Net operating loss – carryforward	$ –	$ –	$ 3
Nonaccrual loan interest	–	–	13
Pensions and other postretirement benefits	–	–	23
Gross deferred tax assets	–	–	39
Gross deferred tax assets, net of valuation allowance	–	–	39
Deferred income tax liabilities:			
Pensions and other postretirement benefits	–	–	(27)
Depreciation	–	–	3
Gross deferred tax liability	–	–	(24)
Net deferred tax asset (liability)	$ –	$ –	$ 15

Prior to 2006, deferred taxes were provided on the basis of a proportionate share of the tax effect of temporary differences from nonpossession sourced income. The expected future tax rates, management estimates and assumptions were based upon enacted tax law, or Section 936/30A. With the expiration of Section 936/30A as of December 31, 2005 and the Association's decision to operate as a sub-chapter T cooperative for federal tax purposes, the basis of enacted tax law changed beginning January 1, 2006.

As discussed in Note 2-H Income Taxes, the Board and management intend that the ACA will only have patronage sourced income that will be distributed in its entirety on a cooperative basis as tax deductible patronage dividends, resulting in zero federal income tax. Thus, beginning in 2006, the Association has applied a zero effective tax rate to its cumulative temporary differences. The result was that the Association wrote-off the balance of net deferred tax assets after making adjusting entries to true-up the temporary difference balances for 2005's federal tax return filing. Refer to the first table above in Note 8.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes,"* on January 1, 2007. As a result of the adoption, there were no potential uncertain positions for income taxes identified and therefore the Association recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no potential uncertain tax positions identified related to the current year. The tax years that remain open for federal and Puerto Rico income tax jurisdictions are 2004 and forward.

Note 9 — Employee Benefit Plans

The employees of the Association may participate in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. As a participating entity in the District's defined benefit plan, the Association funded $0 for 2007, $0 for 2006 and $480 for 2005, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were $263 for 2007, $334 for 2006, and $327 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

The Association participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Association will contribute $.50 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Association will contribute $1.00 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. Employee contributions are not to exceed the maximum contribution limit as established by Hacienda. Employer contributions to this plan were $51, $51, and $48 for the years ended December 31, 2007, 2006 and 2005, respectively.

Total retirement benefits expenses of $339, 398, and $389 for the years ended December 31, 2007, 2006 and 2005, respectively, were included as part of salaries and benefits expense.

The Association also sponsors a fully insured plan providing certain benefits, primarily health and dental care, for its active and retired employees. The measurement date for the plan is September 30. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits expense were $454 for 2007, $409 for 2006 and $538 for 2005. Effective January 1, 2008, the Association moved its eligible retiree and long-term disabled participants into a Medicare Advantage Plan, rather than electing to apply for a direct reimbursement of prescription drug claims through Medicare Part D.

On December 31, 2007, the Association adopted SFAS 158, which requires the recognition of a plan's over-funded or under-funded status as an asset or liability with an offsetting adjustment to accumulated other comprehensive income, net of tax. SFAS 158 requires the determination of the fair values of a plan's assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income, net of tax. These amounts were previously netted against the plans' funded status in the Association's Consolidated Balance Sheets pursuant to the provisions of SFAS 106. These amounts will be subsequently recognized as components of net periodic benefit costs. Further, actuarial gains and losses that arise in subsequent periods that are not initially recognized as a component of net periodic benefit cost will be recognized as a component of accumulated other comprehensive income, net of tax. Those amounts will subsequently be recognized as a component of net periodic benefit cost as they are amortized during future periods.

The incremental effects of adopting the provisions of SFAS 158 on the Association's Consolidated Balance Sheets at December 31, 2007 are presented in the following table. The adoption of SFAS 158 had no effect on the Consolidated Statements of Income for the year ended December 31, 2007, or for any year presented.

	Before Application of SFAS 158	Adjustments	After Application of SFAS 158
Other liabilities	$ 2,850	$ (862)	$ 1,988
Total liabilities	204,984	(862)	204,122
Accumulated other comprehensive income, net of tax	–	862	862
Total retained earnings	54,699	862	55,561
Total liabilities and retained earnings	$ 258,821	$ 862	$ 259,683

SFAS No. 158 also requires that the funded status of a plan be measured as of the date of the year-end for fiscal years ending after December 15, 2008. The current measurement date of September 30 will be changed to December 31 beginning in 2008.

The funding status and the amounts recognized in the Consolidated Balance Sheets of the Association for other postretirement benefit plans follows:

	Other Postretirement Benefits		
	2007	2006	2005
Change in benefit obligation			
Benefit obligation at beginning of year	$ 2,867	$ 2,624	$ 3,331
Service cost	36	50	44
Interest cost	169	135	196
Plan participants' contributions	26	9	38
Plan amendments	–	354	–
Actuarial loss (gain)	(1,769)	(189)	(850)
Benefits paid	(130)	(116)	(135)
Benefit obligation at end of year	$ 1,199	$ 2,867	$ 2,624
Change in plan assets			
Fair value of plan assets, beginning of year	$ –	$ –	$ –
Employer contributions	104	107	97
Plan participants' contributions	26	9	38
Benefits paid	(130)	(116)	(135)
Fair value of plan assets, end of year	$ –	$ –	$ –
Funded status	$ (1,199)	$ (2,867)	$ (2,624)
Unrecognized transition obligation or (asset)	N/A	234	268
Unrecognized prior service cost	N/A	354	–
Unrecognized net loss (gain)	N/A	415	635
Net amount recognized – September 30		(1,864)	(1,721)
Fourth quarter contributions	25	27	25
Net amount recognized	$ (1,174)	$ (1,837)	$ (1,696)
Amounts recognized consist of:			
Current liabilities	$ (75)	N/A	N/A
Noncurrent liabilities	(1,099)	N/A	N/A
Net amount recognized	$ (1,174)	N/A	N/A

The following represent the amounts included in accumulated other comprehensive income at December 31, 2007:

	Other Postretirement Benefits
Net actuarial loss (gain)	$ (1,367)
Prior service costs (credit)	304
Net transition obligation (asset)	201
Total amount recognized in OCI	$ (862)

Accreted into net income during 2008 will be $(25) of actuarial income related to other postretirement benefits; specifically, $34 of net transition obligation (asset), $50 of prior service costs, and $(109) of net actuarial loss (gain).

The net periodic benefit expense for other postretirement benefit plans included in the Consolidated Statements of Income is comprised of the following:

	Other Postretirement Benefits		
	2007	2006	2005
Service cost	$ 36	$ 50	$ 44
Interest cost	169	135	196
Net amortization and deferral	96	65	133
Net periodic benefit (income) expense	$ 301	$ 250	$ 373

Weighted average assumptions used to determine benefit obligations at September 30:

	Other Postretirement Benefits		
	2007	2006	2005
Discount rate	6.45%	6.00%	5.25%

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	Other Postretirement Benefits		
	2007	2006	2005
Discount rate	6.00%	5.25%	6.00%

Assumed healthcare trend rates have a significant effect on the amounts reported for the healthcare plans. A one-percentage point change in the assumed healthcare cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
Effect on total service cost and interest cost components	$ 35	$ (27)
Effect on year-end post-retirement benefit obligation	$ 179	$ (112)

The Association expects to contribute $75 to their other postretirement plans next year.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Other Postretirement Benefits
2008	$ 75
2009	82
2010	81
2011	83
2012	88
Years 2013 — 2017	488

Note 10 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which $1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid $440 million, on behalf of the System, in interest costs on $844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the $440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administrative Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

Note 11 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2007 amounted to $3,041. During 2007, $147 of new loans and advances were made and repayments totaled $852. In the opinion of management, none of these loans outstanding at December 31, 2007 involved more than a normal risk of collectibility.

Note 12 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and commercial letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2007, $47,599 of commitments to extend credit and no commercial letters of credit were outstanding.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2007, the Association had outstanding $2,148 of standby letters of credit, with expiration dates ranging from January 2, 2008 to April 2, 2012. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is $2,148.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2007, the Association's inventory of standby letters of credit had a fair value of $40 and was included in other liabilities.

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

During 2006, the Association agreed to become one of several investors in a USDA approved Rural Business Investment Company (RBIC). At December 31, 2007 there was an outstanding commitment of $145 to make additional equity purchases in the RBIC.

Actions are pending against the Association in which claims for monetary 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.

Note 13 — Disclosures About Fair Value Of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2007, 2006 and 2005. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments are as follows:

	December 31, 2007		December 31, 2006	
	Carrying Amount	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial assets:				
Cash	$ 130	$ 130	$ 132	$ 132
Loans	$ 250,019	$ 250,260	$ 247,136	$ 247,280
Allowance for loan losses	330	–	271	–
Loans, net	$ 249,689	$ 250,260	$ 246,865	$ 247,280
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	$ 197,926	$ 198,128	$ 197,058	$ 196,569

	December 31, 2005	
	Carrying Amount	**Estimated Fair Value**
Financial assets:		
Cash	$ 27	$ 27
Loans	$ 277,468	$ 275,795
Allowance for loan losses	237	–
Loans, net	$ 277,231	$ 275,795
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	$ 225,635	$ 224,309

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

A. **Cash:** The carrying value is a reasonable estimate of fair value.

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

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

   Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

   The carrying value of accrued interest approximates its fair value.

C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 4, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 1.10 percent of the issued stock of the Bank as of December 31, 2007 net of any reciprocal investment. As of that date, the Bank's assets totaled $26.9 billion and shareholders' equity totaled $1,457 million. The Bank's earnings were $192 million during 2007.

D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

E. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

Note 14 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005 follow:

	2007				
	First	Second	Third	Fourth	Total
Net interest income	$ 1,572	$ 1,640	$ 1,649	$ 1,632	$ 6,493
Provision for (reversal of allowance for) loan losses	28	–	19	12	59
Noninterest income (expense), net	(690)	(744)	(623)	(253)	(2,310)
Net income (loss)	$ 854	$ 896	$ 1,007	$ 1,367	$ 4,124

	2006				
	First	Second	Third	Fourth	Total
Net interest income	$ 1,501	$ 1,607	$ 1,589	$ 1,630	$ 6,327
Provision for (reversal of allowance for) loan losses	–	46	(22)	10	34
Noninterest income (expense), net	(599)	(692)	(578)	(196)	(2,065)
Net income (loss)	$ 902	$ 869	$ 1,033	$ 1,424	$ 4,228

	2005				
	First	Second	Third	Fourth	Total
Net interest income	$ 1,604	$ 1,694	$ 1,801	$ 1,894	$ 6,993
Provision for (reversal of allowance for) loan losses	–	–	–	–	–
Noninterest income (expense), net	(1,000)	(997)	(980)	(1,010)	(3,987)
Net income (loss)	$ 604	$ 697	$ 821	$ 884	$ 3,006