



# **FIRST QUARTER 2005**

Management's Discussion and Analysis of Financial Condition and Results of Operations.....	2
Consolidated Financial Statements	
Consolidated Balance Sheets.....	5
Consolidated Statements of Income.....	6
Consolidated Statements of Changes in Stockholders' Equity .....	7
Notes to the Consolidated Financial Statements.....	8



William A. Garrahan  
Chief Executive Officer



Juan A. Santiago  
Chairman of the Board

April 29, 2005

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

*(dollars in thousands)*

The following commentary reviews the consolidated financial condition and results of operations of Puerto Rico Farm Credit, ACA (Association) for the three months ended March 31, 2005. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2004 annual report of the Association.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related business for financing short and intermediate-term loans and long-term real estate mortgage loans. The Association also maintains a portfolio of purchased loans, originated by other Farm Credit System entities and non-system entities. The Association's predominant local service area (LSA) agricultural commodities were dairy, livestock and fruits which totaled approximately \$119 million or 46 percent of all outstanding loan volume at March 31, 2005.

The gross loan volume of the Association at March 31, 2005 was \$257,558 an increase of \$7,063 or 2.8 percent as compared to \$250,495 at December 31, 2004. Net loans outstanding at March 31, 2005 also increased by the same amount, as there was no change in the allowance for loan losses. The improvement in gross loan volume was primarily related to an \$8,505 increase in net participation loans purchased. This increase was partially offset by decreases in both accruing and nonaccruing LSA originated loans.

Net loans at March 31, 2005 made up 97.3 percent of total assets, the same percentage as December 31, 2004. The composition and amount of the Association's various asset categories did not change much during the first quarter of 2004, except for loans.

As a percentage of gross loans, nonaccrual loans equaled .86 percent at March 31, 2005, compared with .99 percent and 1.3 percent at December 31 and March 31, 2004, respectively. The year-over-year decrease in the percentage was primarily the result of a \$600 charge-off recognized during the fourth quarter of 2004 related to the largest nonaccrual account. There is a plan in place to liquidate the remaining collateral.

Due to the substantial increase in loan volume, the overall credit quality of the total portfolio continued to show improvement, which is at the best level of the past ten years. Credit quality has also been supported and enhanced by the lower interest rate environment, favorable weather and stable product demand, which have also had a favorable impact on delinquency rates.

During 2004, the Association completed its study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the Farm Credit Administration (FCA), the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and the resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a \$5,136 reversal of the allowance for loan losses. The Association's allowance for loan losses methodology utilized prior to the study was in accordance with generally accepted accounting principles and was consistently applied.

In April 2004, the FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that should be used in evaluating the adequacy of a System institution's allowance for loan losses. The Farm Credit Administration endorsed the direction provided by these other regulatory agencies and indicated the conceptual framework addressed in this guidance would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors.

The allowance for loan losses was the same at March 31, 2005 as at December 31, 2004. The ratio of allowance to outstanding loan volume was .77 percent at March 31, 2005 compared with .79 percent at December 31, 2004. There were no charge-offs or recoveries during the first quarter of 2005.

## RESULTS OF OPERATIONS

Net income for the three months ended March 31, 2005 totaled \$604, an increase of \$46 or 8.2 percent as compared to the first quarter of 2004. The increase was primarily the result of interest income earned on the higher level of accruing loan volume. At March 31, 2005 net interest income was \$1,604, an increase of \$57 or 3.7 percent compared to the first quarter of 2004. During the first quarter of 2005, interest income on accruing loans increased by \$1,035 to \$3,196 or by \$47.9 percent. This material increase was the result of not only the significant increase in accruing loan volume during the past twelve months, but also the increase in the interest rate environment. However, during the first quarter of 2005, interest expense on notes payable to AgFirst increased by \$978 or 159.3 percent. The reason for such a large percentage increase was an agreement between the Association and AgFirst to change the interest rate pricing formula applied to the direct notes payable to AgFirst. This action was taken as a result of the final phase out of Section 936/30A transition relief, which expires as of December 31, 2005. The effect of this agreement was to raise the Association's cost of borrowing from AgFirst by approximately 30 basis points.

Thus, for 2005 the Association expects to record a smaller increase in net interest income. However, a portion of this reduction in net interest income will be offset as the Association begins to receive annual patronage refund distributions from AgFirst. Previously, the Association received the majority of its funding from the Farm Credit Finance Corporation of Puerto Rico, which resulted in the Association not participating in the annual patronage refund distributions declared by AgFirst

During the first quarter of 2005, the allowance was not changed, resulting in no impact to income.

Noninterest income for the three months ended March 31, 2005 was \$78, an increase of \$12 as compared to the first three months of 2004. Primarily this was the result of additional fee income earned from the increased level of participation loan activity.

Noninterest expense for the three months ended March 31, 2005 increased by \$23 or 2.2 percent compared to the same period of 2004. The increase was primarily related to salaries and benefits which increased \$58 or 8.4 percent due to lower deferred costs related to fewer loan originations. This was partially offset by a \$28 decrease in the Farm Credit System insurance fund premium expense. Management projects a second year of a significant decrease in the expense, as the announced 2005 premium on accruing loans is lower than for 2004.

As a result of the 2001 corporate restructuring, a majority of the Association's business has been conducted in the tax-exempt subsidiary or as possession-sourced activity eligible for tax credits. During the first quarter of 2005, like 2004, the Association did not record a provision for income tax expense.

### **Key Results of Operations Ratios:**

	<b>Annualized for the three months ended 3/31/05</b>	<b>For the year ended 12/31/04</b>
Return on Average Assets	.93%	3.22%
Return on Average Stockholders' Equity	4.54%	16.38%
Net Interest Income as a Percentage of Average Earning Assets	2.57%	2.76%

## LIQUIDITY AND FUNDING SOURCES

### *Liquidity*

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

### *Funding Sources*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate notes are utilized by the Association to fund variable rate loan advances and operating funds requirements. The total notes payable to the Bank at March 31, 2005 was \$208,329 as compared with \$199,477 at December 31, 2004. The increase of \$8,852 or 4.4 percent corresponded to the increase in gross loan volume and the funding of the year-end 2004 dividend.

The Association had no lines of credit outstanding with third parties as of March 31, 2005.

### Funds Management

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

### CAPITAL RESOURCES

Total stockholders' equity at March 31, 2005 increased 1.1 percent to \$53,498 from December 31, 2004 when total stockholders' equity was \$52,904. The increase was primarily attributable to net income retained as unallocated surplus during the quarter.

Total capital stock and participation certificates were \$986 on March 31, 2005 compared to \$998 on December 31, 2004. The decrease of \$12 was the net result of refunding more stock to non-borrowing stockholders than new stockholders purchasing capital stock or participation certificates.

Retained earnings unallocated increased \$606 or 1.2 percent from December 31, 2004 when unallocated retained earnings totaled \$51,906. The increase was primarily from net income earned during the first quarter.

The Board of directors intends to continue its policy of declaring cash dividends. 2004 was twelfth consecutive year of paying dividends. The table below sets forth the amount of dividends declared:

Year	Type	Amount Declared
2004	Patronage	\$ 2,500
2003	Patronage Equity	\$ 1,847 153
2002	Patronage Equity	\$ 1,602 149

The amount of dividends, as always, will depend on continued strong earnings, the overall financial condition of the Association and other factors.

The Association's regulatory permanent capital ratio at March 31, 2005 was 24.99 percent compared to 24.12 percent at December 31, 2004. The Association's total surplus and core surplus ratios were both 24.50 percent at March 31, 2005. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

### Key financial condition ratios were as follows:

	3/31/05	12/31/04
Stockholders' Equity to Assets	20.24%	20.56%
Debt to Stockholders' Equity	3.94:1	3.86:1

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

<i>(dollars in thousands)</i>	<b>March 31,</b>		<b>December 31,</b>
	<b>2005</b>	<b>2004</b>	<b>2004</b>
	<i>(unaudited)</i>		
<b>Assets</b>			
Cash	\$ 229	\$ 127	\$ 322
Loans	257,558	238,288	250,495
Less: allowance for loan losses	198	5,983	198
Net loans	257,360	232,305	250,297
Accrued interest receivable	1,481	1,046	1,262
Investment in other Farm Credit institutions	2,712	4,712	2,712
Premises and equipment, net	399	584	439
Other property owned	150	—	150
Prepaid retirement expense	1,872	—	1,954
Other assets	169	240	144
Total assets	\$ 264,372	\$ 239,014	\$ 257,280
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 208,329	\$ 189,313	\$ 199,477
Accrued interest payable	565	209	439
Dividend payable	—	1	2,500
Postretirement benefits other than pensions	1,491	1,247	1,423
Minimum pension liability	—	1,317	—
Other liabilities	489	516	537
Total liabilities	210,874	192,603	204,376
Commitments and contingencies			
<b>Members' Equity</b>			
Capital stock and participation certificates	986	1,020	998
Unallocated retained earnings	52,512	47,212	51,906
Accumulated other comprehensive income (loss)	—	(1,821)	—
Total stockholders' equity	53,498	46,411	52,904
Total liabilities and stockholders' equity	\$ 264,372	\$ 239,014	\$ 257,280

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

*Puerto Rico Farm Credit, ACA*  
**Consolidated Statements of Income**

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Interest Income</b>		
Loans	\$ 3,196	\$ 2,161
<b>Interest Expense</b>		
Notes payable to AgFirst Farm Credit Bank	1,592	614
Net interest income	1,604	1,547
Provision for (reversal of) loan losses	—	—
Net interest income after provision for (reversal of) loan losses	1,604	1,547
<b>Noninterest Income</b>		
Loan fees	62	47
Fees for financially related services	3	3
Other noninterest income	13	16
Total noninterest income	78	66
<b>Noninterest Expense</b>		
Salaries and employee benefits	748	690
Occupancy and equipment	59	56
Insurance Fund premium	24	52
Guarantee fee	50	52
Other operating expenses	197	205
Total noninterest expense	1,078	1,055
Income before income taxes	604	558
Provision (benefit) for income taxes	—	—
Net income	\$ 604	\$ 558

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

*Puerto Rico Farm Credit, ACA*

# Consolidated Statements of Changes in Stockholders' Equity

*(unaudited)*

<i>(dollars in thousands)</i>	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings Unallocated</b>	<b>Other Comprehensive Income</b>	<b>Total Stockholders' Equity</b>
Balance at December 31, 2003	\$ 1,022	\$ 46,654	\$ (1,821)	\$ 45,855
Net income		558		558
Capital stock/participation certificates issued	16			16
Capital stock/participation certificates retired	(18)			(18)
Balance at March 31, 2004	<u>\$ 1,020</u>	<u>\$ 47,212</u>	<u>\$ (1,821)</u>	<u>\$ 46,411</u>
Balance at December 31, 2004	\$ 998	\$ 51,906	\$ —	\$ 52,904
Net income		604		604
Capital stock/participation certificates issued	10			10
Capital stock/participation certificates retired	(22)			(22)
Distribution adjustment		2		2
Balance at March 31, 2005	<u>\$ 986</u>	<u>\$ 52,512</u>	<u>\$ —</u>	<u>\$ 53,498</u>

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

# Notes to the Consolidated Financial Statements

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

## NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Puerto Rico Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2004, are contained in the 2004 Annual Report to Stockholders. These unaudited first quarter 2005 consolidated financial statements should be read in conjunction with the 2004 Annual Report to Stockholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the three months ended March 31, 2005, are not necessarily indicative of the results to be expected for the year ending December 31, 2005.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of March 31, 2005, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

Balance at 12-31-03	\$ 5,983
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	—
Balance at 3-31-04	<u>\$ 5,983</u>
Balance at 12-31-04	\$ 198
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	—
Balance at 3-31-05	<u>\$ 198</u>

As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of \$5,185 in the fourth quarter of 2004 that resulted in a decrease in the allowance for loan losses.

## NOTE 3 – COMMITMENTS AND CONTINGENT LIABILITIES

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

## NOTE 4 – EMPLOYEE BENEFIT PLANS

The Association participates in a Districtwide defined benefit retirement plan. The costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the District's salary expense. The Association also participates in a Districtwide Thrift Plan.

The Association sponsors a plan providing certain benefits (primarily health care) to its retirees. The following table sets forth the components of net periodic benefit costs of the other postretirement benefits plan for the three months ended March 31, 2005:

	<b>For the three months ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Service cost	\$ 11	\$ 12
Interest cost	49	42
Amortization of net (gain) loss	8	11
Recognized net actuarial (gain) loss	25	16
Net periodic benefit cost	<u>\$ 93</u>	<u>\$ 81</u>

The following is a table of retirement and postretirement benefit expense for the three months ended March 31, 2005:

	<b>For the three months ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Pension	\$ 82	\$ 94
Thrift	17	16
Other postretirement benefits	93	81
Total	<u>\$ 192</u>	<u>\$ 191</u>

As of March 31, 2005, no contributions have been made to the pension plan for 2005. Actuarial projections as of the last plan measurement date (September 30, 2004) did not anticipate any contributions for 2005; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.