



# **FIRST QUARTER 2007**

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William A. Garrahan  
Chief Executive Officer



Juan A. Santiago  
Chairman of the Board

April 27, 2007

# 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, 2007. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2006 annual report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **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 agricultural commodities were dairy, livestock, field crops and fruits which totaled approximately \$110.6 million or 44.9 percent of all outstanding loan volume at March 31, 2007.

The gross loan volume of the Association at March 31, 2007 was \$246,532 a decrease of \$604 or .24 percent as compared to \$247,136 at December 31, 2006. Loans originated within the Association's chartered territory increased by approximately \$4,708 thousand, while participation loans purchased decreased by approximately \$5,312.

Net loans outstanding at March 31, 2007 totaled \$246,233 as compared to \$246,865 at December 31, 2006. Besides the \$604 decrease related to loan volume, the additional \$28 decrease related to an increase in the allowance for loan losses. Net loans at March 31, 2007 made up 96.5 percent of total assets as compared to 95.8 percent at December 31, 2006. The change related to a decrease in other assets, plus the reduction in the receivable from AgFirst Farm Credit Bank (the Bank) which was paid in January 2007.

As a percentage of gross loans, nonaccrual loans equaled 1.09 percent at March 31, 2007, compared with .82 percent at December 31, 2006. Despite the decrease in loan volume, credit quality ratios were not impacted and remained at relatively higher levels, when compared to 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 positive impact on delinquency rates.

The allowance for loan losses was \$299 at March 31, 2007, an increase of \$28 from December 31, 2006. The increase reflected the downgrade in credit quality of a specific participation loan, but did not require the recognition of a specific allowance. The ratio of allowance to gross outstanding loan volume at March 31, 2007 was .12 percent, compared to .11 percent at December 31, 2006. There were no charge-offs or recoveries during the first quarter of 2007.

## **RESULTS OF OPERATIONS**

Net income for the three months ended March 31, 2007 totaled \$854 a decrease of \$48 or 5.3 percent as compared to \$902 for the first quarter of 2006. The decrease resulted primarily from the \$28 provision expense to increase the allowance and the \$37 less accrued for the first quarter's estimated patronage dividend receivable from the Bank. Otherwise, higher net interest income and loan fees more than offset higher operating expenses.

During the first quarter of 2007, interest income increased by \$268 to \$4,599 or 6.2 percent. This was partially offset by an increase in interest expense of \$197 to \$3,027 or 7.0 percent. Thus, net interest income increased by \$71 to \$1,572 at March 31, 2007 compared to \$1,501 at March 31, 2006, or 4.7 percent.

During the first quarter of 2007, the Association recorded a provision expense for loan losses which totaled \$28. This compared to zero provision expense during the first quarter of 2006.

Noninterest income for the three months ended March 31, 2007 was \$521, an increase of \$11, or 2.2 percent higher than the \$510 recognized during the first three months of 2006. This increase was the net result of higher fee income related to servicing loans and lower estimated patronage income from the Bank. The estimated patronage dividend income accrual was lower due to the decrease in outstanding loan volume funded through the Bank.

Noninterest expense for the three months ended March 31, 2007 increased by \$102 or 9.2 percent compared to the same three months of 2006. The increase was primarily related to an increase of \$85 in salaries and benefits, which partially resulted from none cash charges related to GAAP accounting for annual leave and originating loans.

### Key Results of Operations Ratios:

|  | Annualized for<br>the three months<br>ended 3/31/07 | For the<br>year ended<br>12/31/06 |
|--|---|-----------------------------------|
| Return on Average Assets   | .79%  | 1.62%                             |
| Return on Average Stockholders' Equity                           | 3.76%   | 7.73%                             |
| Net Interest Income as a Percentage<br>of Average Earning Assets | 2.38%   | 2.53%                             |

### 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, 2007 was \$193,800 as compared with \$197,058 at December 31, 2006. The decrease of \$3,258 or 1.7 percent during the first quarter corresponded very closely to the reduction in due from the AgFirst Bank and other assets.

The Association had no lines of credit outstanding with third parties as of March 31, 2007.

#### Funds Management

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers variable and fixed rate loan products which are competitively priced according to local 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 members' equity at March 31, 2007 increased 1.7 percent to \$54,714 from December 31, 2006 when total members' equity was \$53,815. The increase was primarily attributable to net income retained as unallocated surplus during the quarter.

Total capital stock and participation certificates were \$855 on March 31, 2007 compared to \$874 on December 31, 2006. The decrease of \$19 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 \$918 or 1.7 percent from December 31, 2006 when unallocated retained earnings totaled \$52,941. The increase was from net income earned during the quarter and a patronage dividend adjustment of \$64 to reconcile the year-end estimated dividend payable to the Association's 2006 federal taxable income.

The Board of directors intends to continue its policy of declaring cash dividends. 2006 was the fourteenth consecutive year of paying dividends. The table below sets forth the recent amount of patronage dividends declared:

| Year | Amount<br>Declared |
|------|--------------------|
| 2006 | \$3,200            |
| 2005 | \$3,000            |
| 2004 | \$2,500            |

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, 2007 was 23.33 percent compared to 24.31 percent at December 31, 2006. The Association's total surplus and core surplus ratios were both 22.94 percent at March 31, 2007. 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:

|                                | 3/31/07 | 12/31/06 |
|--------------------------------|---------|----------|
| Stockholders' Equity to Assets | 21.44%  | 20.88%   |
| Debt to Stockholders' Equity   | 3.66:1  | 3.79:1   |

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## ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employees’ 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 comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. 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 Association uses a measurement date of September 30<sup>th</sup>. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have little to no impact on the income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the balance sheet.

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**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst’s annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at its website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association’s annual and quarterly reports are also available upon request free of charge by calling 1-800-981-3323, or writing Bruce M Hoffman, CFO, Puerto Rico Farm Credit, ACA, PO Box 363649, San Juan, PR 00936-3649, or accessing the website, [www.puertoricofarmcredit.com](http://www.puertoricofarmcredit.com). The Association prepares a quarterly report within 45 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.

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

| <i>(dollars in thousands)</i>                | <b>March 31,</b>   |                    | <b>December 31,</b> |
|--|--------------------|--------------------|---------------------|
|  | <b>2007</b>        | <b>2006</b>        | <b>2006</b>         |
|  | <i>(unaudited)</i> | <i>(unaudited)</i> | <i>(audited)</i>    |
| <b>Assets</b>                                |                    |                    |                     |
| Cash   | \$ 212             | \$ 222             | \$ 132              |
| Loans  | 246,532            | 254,675            | 247,136             |
| Less: allowance for loan losses              | 299                | 237                | 271                 |
| Net loans                                    | 246,233            | 254,438            | 246,865             |
| Accrued interest receivable                  | 2,071              | 1,909              | 1,907               |
| Investment in other Farm Credit institutions | 3,670              | 2,864              | 3,670               |
| Premises and equipment, net                  | 779                | 497                | 792                 |
| Other property owned                         | —                  | 150                | —                   |
| Prepaid retirement expense                   | 1,707              | 2,022              | 1,772               |
| Due from AgFirst Farm Credit Bank            | 376                | 413                | 1,919               |
| Other assets                                 | 189                | 645                | 683                 |
| Total assets                                 | <u>\$ 255,237</u>  | <u>\$ 263,160</u>  | <u>\$ 257,740</u>   |
| <b>Liabilities</b>                           |                    |                    |                     |
| Notes payable to AgFirst Farm Credit Bank    | \$ 193,800         | \$ 206,072         | \$ 197,058          |
| Accrued interest payable                     | 1,005              | 965                | 1,014               |
| Dividends payable                            | —                  | —                  | 3,200               |
| Postretirement benefits other than pensions  | 1,886              | 1,731              | 1,837               |
| Other liabilities                            | 3,832              | 651                | 816                 |
| Total liabilities                            | <u>200,523</u>     | <u>209,419</u>     | <u>203,925</u>      |
| Commitments and contingencies                |                    |                    |                     |
| <b>Members' Equity</b>                       |                    |                    |                     |
| Capital stock and participation certificates | 855                | 926                | 874                 |
| Unallocated retained earnings                | 53,859             | 52,815             | 52,941              |
| Total members' equity                        | <u>54,714</u>      | <u>53,741</u>      | <u>53,815</u>       |
| Total liabilities and members' equity        | <u>\$ 255,237</u>  | <u>\$ 263,160</u>  | <u>\$ 257,740</u>   |

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

*Puerto Rico Farm Credit, ACA*

# Consolidated Statements of Income

(unaudited)

| <i>(dollars in thousands)</i>  | <b>For the three months<br/>ended March 31,</b> |             |
|--|---|-------------|
|  | <b>2007</b>                                     | <b>2006</b> |
| <b>Interest Income</b>   |   |             |
| Loans  | \$ 4,596  | \$ 4,327    |
| Investment securities  | 3   | 4           |
|  | 4,599   | 4,331       |
| <b>Interest Expense</b>  |   |             |
| Notes payable to AgFirst Farm Credit Bank  | 3,027   | 2,830       |
|  | 3,027   | 2,830       |
| Net interest income  | 1,572   | 1,501       |
| Provision for (reversal of allowance for) loan losses                              | 28  | —           |
|  | 1,544   | 1,501       |
| Net interest income after provision for<br>(reversal of allowance for) loan losses | 1,544   | 1,501       |
| <b>Noninterest Income</b>  |   |             |
| Loan fees  | 115   | 69          |
| Fees for financially related services  | 2   | 3           |
| Equity in earnings of other Farm Credit institutions                               | 376   | 413         |
| Other noninterest income   | 28  | 25          |
|  | 521   | 510         |
| Total noninterest income   | 521   | 510         |
| <b>Noninterest Expense</b>   |   |             |
| Salaries and employee benefits   | 820   | 735         |
| Occupancy and equipment  | 64  | 61          |
| Insurance Fund premium   | 82  | 83          |
| Guarantee fee  | —   | 16          |
| Other operating expenses   | 245   | 213         |
| Losses on other property owned, net  | —   | 1           |
|  | 1,211   | 1,109       |
| Total noninterest expense  | 1,211   | 1,109       |
| Income before income taxes   | 854   | 902         |
| Provision (benefit) for income taxes   | —   | —           |
|  | 854   | 902         |
| Net income   | \$ 854  | \$ 902      |

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

*Puerto Rico Farm Credit, ACA*

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

|  | <b>Capital<br/>Stock and<br/>Participation<br/>Certificates</b> | <b>Retained<br/>Earnings<br/>Unallocated</b> | <b>Total<br/>Members'<br/>Equity</b> |
|--|---|--|--------------------------------------|
| Balance at December 31, 2005                     | \$ 940  | \$ 51,913                                    | \$ 52,853                            |
| Net income                                       |   | 902  | 902                                  |
| Capital stock/participation certificates issued  | 7   |  | 7                                    |
| Capital stock/participation certificates retired | (21)  |  | (21)                                 |
| Balance at March 31, 2006                        | <u>\$ 926</u>   | <u>\$ 52,815</u>                             | <u>\$ 53,741</u>                     |
| Balance at December 31, 2006                     | \$ 874  | \$ 52,941                                    | \$ 53,815                            |
| Net income                                       |   | 854  | 854                                  |
| Capital stock/participation certificates issued  | 8   |  | 8                                    |
| Capital stock/participation certificates retired | (27)  |  | (27)                                 |
| Distribution adjustment                          |   | 64   | 64                                   |
| Balance at March 31, 2007                        | <u>\$ 855</u>   | <u>\$ 53,859</u>                             | <u>\$ 54,714</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, 2006, are contained in the 2006 Annual Report to Shareholders. These unaudited first quarter 2007 consolidated financial statements should be read in conjunction with the 2006 Annual Report to Shareholders.

On September 29, 2006, the Financial Accounting Standards Board 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 comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. 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 Association 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. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

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, 2007, are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

Certain amounts in prior period consolidated financial statements may 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, 2007, 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:

|   | For the three months ended March 31, |               |
|---|--------------------------------------|---------------|
|   | 2007                                 | 2006          |
| Balance at beginning of period          | \$ 271                               | \$ 237        |
| Provision for (reversal of) loan losses | 28                                   | –             |
| Loans (charged off), net of recoveries  | –                                    | –             |
| Balance at end of period                | <u>\$ 299</u>                        | <u>\$ 237</u> |

## NOTE 3 – COMMITMENTS AND CONTINGENT LIABILITIES

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

## 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. Both plans also qualify under Puerto Rico law.

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, 2007:

|  | <b>For the three months<br/>ended March 31,</b> |              |
|--|---|--------------|
|  | <b>2007</b>                                     | <b>2006</b>  |
| Service cost   | \$ 9  | \$ 12        |
| Interest cost  | 42  | 34           |
| Amortization of net transition<br>obligation (asset) | 8   | 9            |
| Amortization of prior service cost                   | 13  | —            |
| Amortization of net (gain) loss                      | 3   | 7            |
| Net periodic benefit cost                            | <u>\$ 75</u>                                    | <u>\$ 62</u> |

The following is a table of retirement and postretirement benefit expense for the three months ended March 31, 2007:

|                               | <b>For the three months<br/>ended March 31,</b> |               |
|-------------------------------|---|---------------|
|                               | <b>2007</b>                                     | <b>2006</b>   |
| Pension                       | \$ 66   | \$ 84         |
| Thrift                        | 17  | 15            |
| Other postretirement benefits | 75  | 62            |
| Total                         | <u>\$ 158</u>                                   | <u>\$ 161</u> |

As of March 31, 2007, no contributions have been made to the pension plan for 2007. Actuarial projections as of the last plan measurement date (September 30, 2006) did not anticipate any contributions for 2007; 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.