



SECOND QUARTER 2006

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William A. Garrahan
Chief Executive Officer



Juan A. Santiago
Chairman of the Board

July 28, 2006

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

(dollars in thousands)

The following commentary reviews the consolidated financial condition and results of operations of Puerto Rico Farm Credit, ACA (Association) for the six months ended June 30, 2006. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2005 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 participation loans, originated by other Farm Credit System entities and non-system entities. The Association's predominant local service area agricultural commodities were dairy, livestock and fruits which totaled approximately \$95.4 million or 37.5 percent of all outstanding loan volume at June 30, 2006.

The gross loan volume of the Association at June 30, 2006 was \$255,192 a decrease of \$22,276 or 8.0 percent as compared to \$277,468 at December 31, 2005. During the first six months, following objectives established by the Board of Directors, the Association participated part of its originated loan portfolio to the AgFirst FCB (the Bank). This action resulted in a reduction in loan volume of approximately \$7,128. Additionally, during the first quarter, pay offs further reduced loan volume by approximately \$19,000. These reductions have been partially offset by an increase in participation loans purchased. At June 30, 2006, the Association's loan portfolio consisted of \$166,791 in originated loan volume and \$88,401 in participation purchased loan volume.

Net loans outstanding at June 30, 2006 totaled \$254,909, a decrease of \$22,322 or 8.1 percent. Net loans at June 30, 2006 made up 95.3 percent of total assets, compared to 97.4 percent at December 31, 2005. Besides the material decrease in loan volume, other assets increased due to recognizing higher receivables and a temporary increase in the level of cash at the end of June.

As a percentage of gross loans, nonaccrual loans equaled .84 percent at June 30, 2006, compared with .58 percent and .70 percent at December 31 and June 30, 2005, respectively. Despite the decrease in loan volume, credit quality ratios were not negatively impacted and remained at relatively higher levels, when compared to the past five 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.

The allowance for loan losses was \$283 at June 30, 2006, an increase of \$46 from December 31, 2005. The increased allowance recognized the higher level of participation purchased loan volume. The ratio of allowance to outstanding loan volume was .11 percent at June 30, 2006 compared with .09 percent at December 31, 2005. There were no charge-offs or recoveries during the first six months of 2006.

RESULTS OF OPERATIONS

Net income for the six months ended June 30, 2006 totaled \$1,771, an increase of \$470 or 36.1 percent as compared to \$1,309 for the first two quarters of 2005. The increase primarily resulted from the Association and the Bank redefining the direct note borrowing relationship, with the expiration of IRS Section 936 as of December 31, 2005. As a result of this change net interest income decreased by \$190 or 5.8 percent to \$3,108 for the first two quarters of 2006, as compared to \$3,298 for the first six months of 2005. However, this was more than offset by accruing the Bank's projected annual patronage dividend distribution for 2006. For the six months ended June 30, 2006 equity earnings of other Farm Credit institutions totaled \$805, as compared to no such income recognized during 2005.

During the first six months of 2006, interest income on accruing loans totaled \$8,898, an increase of \$2,156 or 32.0 percent from \$6,742 as of June 30, 2005. This material increase was the result of not only the increase in accruing loan volume, but primarily resulted from the higher interest rate environment. However, interest expense for the first six months payable to the Bank increased by \$2,346 or 68.1 percent, primarily due to the change in the direct note pricing agreement with the Bank. For 2006, the Association expects to show a decrease in net interest income as compared to 2005. However, this decrease will be more than offset by the patronage refund distribution received from the Bank.

During the first quarter of 2006, the allowance was increased by \$46, reducing net income.

Noninterest income for the six months ended June 30, 2006 was \$977, an increase of \$812 as compared to the first six months of 2005. Primarily, this was the result of recording patronage income due from the Bank which totaled \$805.

Noninterest expense for the six months ended June 30, 2006 increased by \$104 or 4.8 percent compared to the same period of 2005. The increase was primarily related to an increase in the insurance fund premium of \$118, which was partially offset by a decrease in the guarantee fee. This offsetting relationship between these two expense categories will be in place for the entire year. The insurance fund increased premiums on accruing loans by 140 percent for 2006 and the guarantee fee paid to the Bank expired with the sale of participation loans to the Bank. Other operating expenses increased by \$66 primarily due to the higher costs of compliance with new governance regulations and the costs of audit examinations.

During the first two quarters of 2006, like 2005, the Association did not record a provision for current year income tax expense. However, during the second quarter of 2006 the Association made a payment related to filing 2005's federal tax return.

For the three months ended June 30, 2006

Net income for the second quarter of 2006 totaled \$869 compared to \$697 for the second quarter of 2005. Net interest income for the three months ended June 30, 2006 was \$1,607 compared to \$1,694 for the three months ended June 30, 2005, reflecting the change in the financing agreement with the Bank.

Noninterest income for the second quarter of 2006 was \$467, an increase of \$380 when compared to the second quarter of 2005. Again, this was the result of recognizing \$392 in estimated patronage due from the Bank.

For the second quarter of 2006, noninterest expense increased by \$73 to total \$1,157 compared to the second quarter of 2005 which totaled \$1,084. The increase for the quarter resulted for the same reason as the year-to-date increase.

Key Results of Operations Ratios:

	Annualized for the six months ended 6/30/06	For the year ended 12/31/05
Return on Average Assets	1.34%	1.12%
Return on Average Members' Equity	6.61%	5.53%
Net Interest Income as a Percentage of Average Earning Assets	2.43%	2.69%

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 June 30, 2006 was \$205,254 as compared with \$225,635 at December 31, 2005. The decrease of \$20,381 or 9.0 percent during the first six months corresponded very closely to the decrease in gross loan volume outstanding and the funding of the 2005 year end dividend.

The Association had no lines of credit outstanding with third parties as of June 30, 2006.

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 June 30, 2006 increased 3.3 percent to \$54,598 from December 31, 2005 when total members' equity was \$52,853. The increase was primarily attributable to net income retained as unallocated surplus during the first two quarters of 2006.

Total capital stock and participation certificates were \$910 on June 30, 2006 compared to \$940 on December 31, 2005. The decrease of \$30 was the net result of refunding more stock to non-borrowing members than new members purchasing capital stock or participation certificates.

Retained earnings unallocated increased \$1,775 or 3.4 percent from December 31, 2005 when unallocated retained earnings totaled \$51,913. The increase was primarily from net income earned, during the current year.

The Board of directors intends to continue its policy of declaring cash dividends. 2005 was the thirteenth consecutive year of paying dividends. The table below sets forth the amount of dividends declared:

Year	Type	Amount Declared
2005	Patronage	\$ 3,000
2004	Patronage	\$ 2,500
2003	Patronage and Equity	\$ 2,000

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

The Association's regulatory permanent capital ratio at June 30, 2006 was 23.25 percent compared to 24.02 percent at December 31, 2005. The Association's total surplus and core surplus ratios were both 22.84 percent at June 30, 2006. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

Key financial condition ratios were as follows:

	6/30/06	12/31/05
Members' Equity to Assets	20.41%	18.57%
Debt to Members' Equity	3.90:1	4.39:1

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 their website, 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, 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. 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>	June 30,		December 31,
	2006	2005	2005
	<i>(unaudited)</i>		<i>(audited)</i>
Assets			
Cash	\$ 4,153	\$ —	\$ 27
Loans	255,192	266,919	277,468
Less: allowance for loan losses	283	226	237
Net loans	254,909	266,693	277,231
Accrued interest receivable	2,052	1,609	1,687
Investment in other Farm Credit institutions	2,864	2,712	2,864
Premises and equipment, net	523	461	482
Other property owned	150	150	150
Prepaid retirement expense	1,939	1,790	2,106
Due from AgFirst Farm Credit Bank	805	—	—
Other assets	142	152	138
Total assets	<u>\$ 267,537</u>	<u>\$ 273,567</u>	<u>\$ 284,685</u>
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 205,254	\$ 214,289	\$ 225,635
Accrued interest payable	1,009	653	890
Dividends payable	—	—	3,000
Postretirement benefits other than pensions	1,767	1,559	1,696
Other liabilities	4,909	2,885	611
Total liabilities	<u>212,939</u>	<u>219,386</u>	<u>231,832</u>
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	910	973	940
Unallocated retained earnings	53,688	53,208	51,913
Total members' equity	<u>54,598</u>	<u>54,181</u>	<u>52,853</u>
Total liabilities and members' equity	<u>\$ 267,537</u>	<u>\$ 273,567</u>	<u>\$ 284,685</u>

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

Puerto Rico Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended June 30,		For the six months ended June 30,	
	2006	2005	2006	2005
Interest Income				
Loans	\$ 4,567	\$ 3,546	\$ 8,898	\$ 6,742
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	2,960	1,852	5,790	3,444
Net interest income	1,607	1,694	3,108	3,298
Provision for (reversal of allowance for) loan losses	46	—	46	—
Net interest income after provision for (reversal of allowance for) loan losses	1,561	1,694	3,062	3,298
Noninterest Income				
Loan fees	72	83	141	145
Fees for financially related services	2	3	5	6
Equity in earnings of other Farm Credit institutions	392	—	805	—
Other noninterest income	1	1	26	14
Total noninterest income	467	87	977	165
Noninterest Expense				
Salaries and employee benefits	719	707	1,454	1,455
Occupancy and equipment	66	65	127	124
Insurance Fund premium	83	24	166	48
Guarantee fee	—	47	16	97
Other operating expenses	289	239	502	436
Losses on other property owned, net	—	2	1	2
Total noninterest expense	1,157	1,084	2,266	2,162
Income before income taxes	871	697	1,773	1,301
Provision (benefit) for income taxes	2	—	2	—
Net income	\$ 869	\$ 697	\$ 1,771	\$ 1,301

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)

	Capital Stock and Participation Certificates	Retained Earnings Unallocated	Total Members' Equity
Balance at December 31, 2004	\$ 998	\$ 51,906	\$ 52,904
Net income		1,301	1,301
Capital stock/participation certificates issued	18		18
Capital stock/participation certificates retired	(43)		(43)
Distribution adjustment		1	1
Balance at June 30, 2005	<u>\$ 973</u>	<u>\$ 53,208</u>	<u>\$ 54,181</u>
Balance at December 31, 2005	\$ 940	\$ 51,913	\$ 52,853
Net income		1,771	1,771
Capital stock/participation certificates issued	14		14
Capital stock/participation certificates retired	(44)		(44)
Distribution adjustment		4	4
Balance at June 30, 2006	<u>\$ 910</u>	<u>\$ 53,688</u>	<u>\$ 54,598</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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited second quarter 2006 consolidated financial statements should be read in conjunction with the 2005 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the six months ended June 30, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2006, 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 12-31-04	\$ 198
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	28
Balance at 6-30-05	<u>\$ 226</u>
Balance at 12-31-05	\$ 237
(Reversal of) provision for loan losses	46
Recoveries, net of loans charged off	—
Balance at 6-30-06	<u>\$ 283</u>

NOTE 3 – CAPITAL

Beginning in 2006, the Association has chosen to operate as a cooperative that qualifies for federal tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds. It is projected that provisions for federal income tax will be recorded only on those earnings not distributed. The Association intends to distribute 100 percent of patronage on the basis of taxable

income. Management is of the opinion that any tax impact, as it relates to net deferred tax assets, will not be material.

NOTE 4 – 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 5 – 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 six months ended June 30, 2006:

	For the six months ended June 30,	
	2006	2005
Service cost	\$ 25	\$ 22
Interest cost	67	98
Amortization of net transition obligation (asset)	17	—
Amortization of net (gain) loss	—	17
Recognized net actuarial (gain) loss	16	49
Net periodic benefit cost	<u>\$ 125</u>	<u>\$ 186</u>

The following is a table of retirement and postretirement benefit expense for the six months ended June 30, 2006:

	For the six months ended June 30,	
	2006	2005
Pension	\$ 167	\$ 163
Thrift	31	32
Other postretirement benefits	125	186
Total	<u>\$ 323</u>	<u>\$ 381</u>

As of June 30, 2006, no contributions have been made to the pension plan for 2006. Actuarial projections as of the last plan measurement date (September 30, 2005) did not anticipate any contributions for 2006; 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.