WE'VE GOT CONNECTIONS.

AgFirst Farm Credit Bank 2004 Annual Report

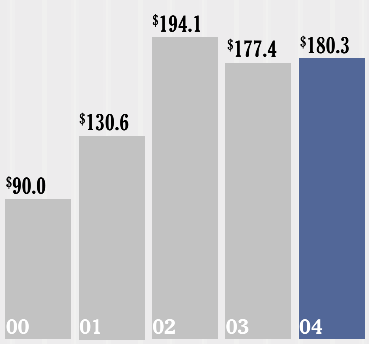
Contents

Financial Highlights

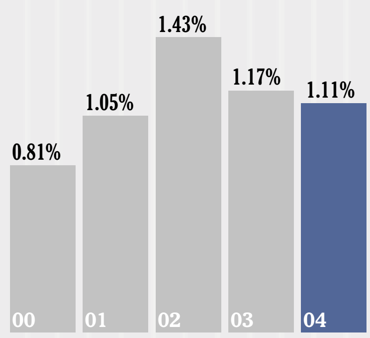
Five-Year Summary of Selected Consolidated Financial Data

(unaudited)

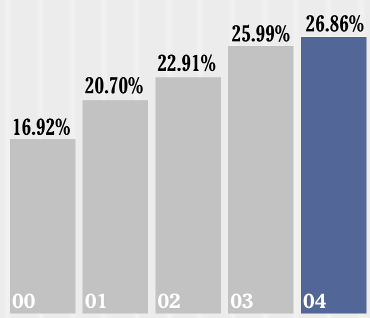
	December 31,				
(dollars in thousands)	**2004**	**2003**	**2002**	**2001**	**2000**
Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 470,258	$ 469,945	$ 359,819	$ 265,254	$ 241,588
Investment securities, available for sale	3,278,414	2,832,716	2,153,118	1,663,323	2,000,086
Loans	12,908,249	12,375,351	12,008,041	11,128,810	9,496,503
Less: allowance for loan losses	14,800	34,168	31,155	25,616	21,416
Net loans	12,893,449	12,341,183	11,976,886	11,103,194	9,475,087
Other assets	245,402	235,704	211,367	201,634	197,338
Total assets	$ 16,887,523	$ 15,879,548	$ 14,701,190	$ 13,233,405	$ 11,914,099
Obligations with maturities of one year or less	$ 6,533,020	$ 6,384,790	$ 6,273,546	$ 7,976,947	$ 6,556,988
Obligations with maturities greater than one year	9,105,207	8,315,226	7,444,960	4,302,671	4,669,337
Mandatorily redeemable preferred stock	225,000	225,000	—	—	—
Total liabilities	15,863,227	14,925,016	13,718,506	12,279,618	11,226,325
Mandatorily redeemable preferred stock	—	—	225,839	225,839	—
Perpetual preferred stock	150,000	150,000	—	—	—
Capital stock and participation certificates	226,200	229,083	249,444	281,803	301,189
Retained earnings	644,366	601,699	527,673	439,104	388,035
Accumulated other comprehensive income (loss)	3,730	(26,250)	(20,272)	7,041	(1,450)
Total shareholders' equity	1,024,296	954,532	756,845	727,948	687,774
Total liabilities and shareholders' equity	$ 16,887,523	$ 15,879,548	$ 14,701,190	$ 13,233,405	$ 11,914,099



Net Income
(dollars in millions)

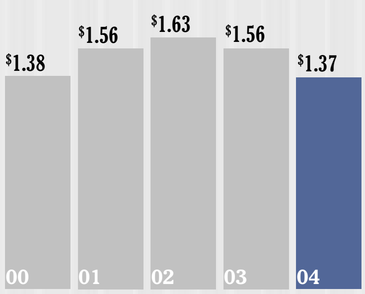


Return on Assets

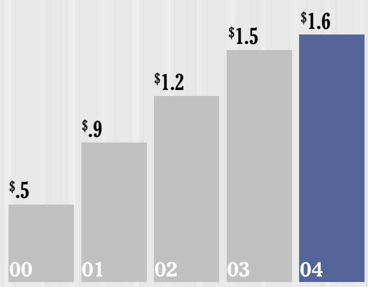


Permanent Capital Ratio

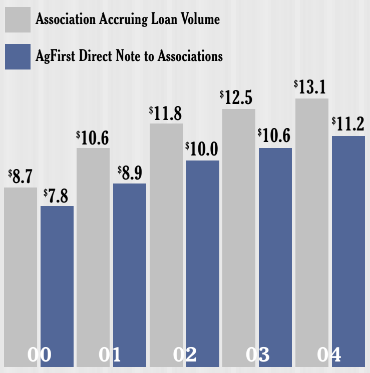
(dollars in thousands)	December 31, 2004	2003	2002	2001	2000
Consolidated Statement of Income Data					
Net interest income	$ 211,595	$ 244,057	$ 255,660	$ 184,782	$ 135,164
Provision for (reversal of) loan losses	(15,292)	2,500	8,000	4,500	2,500
Noninterest income (expense), net	(46,581)	(64,108)	(53,527)	(49,676)	(42,621)
Net income	$ 180,306	$ 177,449	$ 194,133	$ 130,606	$ 90,043
Consolidated Key Financial Ratios					
Rate of return on average:					
Total assets	1.11%	1.17%	1.43%	1.05%	0.81%
Total shareholders' equity	17.16%	20.37%	23.75%	17.40%	12.72%
Net interest income as a percentage of average earning assets	1.32%	1.62%	1.91%	1.50%	1.23%
Net chargeoffs (recoveries) to average loans	0.033%	(0.004)%	0.021%	0.003%	0.006%
Total shareholders' equity to total assets	6.07%	6.01%	5.15%	5.50%	5.77%
Debt to shareholders' equity (:1)	15.49	15.64	18.13	16.87	16.32
Allowance for loan losses to loans	0.11%	0.28%	0.26%	0.23%	0.23%
Permanent capital ratio	26.86%	25.99%	22.91%	20.70%	16.92%
Total surplus ratio	26.76%	25.79%	22.69%	19.86%	15.50%
Core surplus ratio	15.60%	14.45%	13.20%	10.39%	10.42%
Collateral ratio	106.88%	106.94%	105.94%	106.38%	104.95%
Net Income Distribution					
Cash distributions	$ 126,689	$ 92,129	$ 86,677	$ 67,786	$ 61,333
Mandatorily Redeemable Preferred Stock Dividend	—	10,282	18,887	10,912	—
Perpetual Preferred Stock Dividend	10,950	1,851	—	—	—



Participations/Syndications Year-End Volume
(dollars in billions)

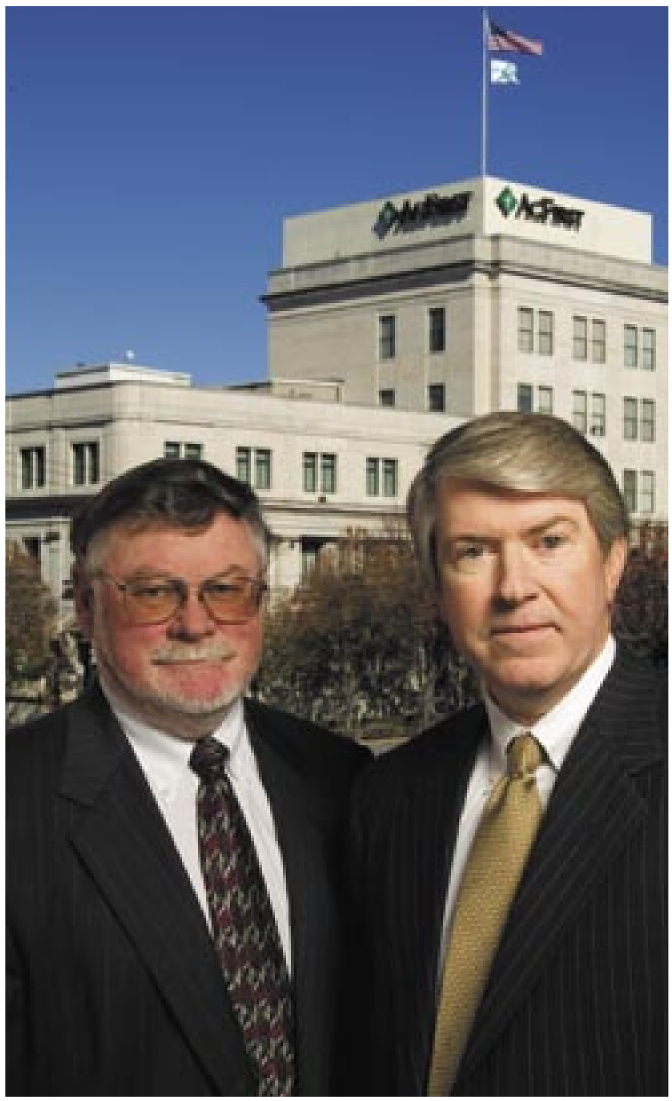


Loans Serviced by Secondary Mortgage Market Unit
(dollars in billions)



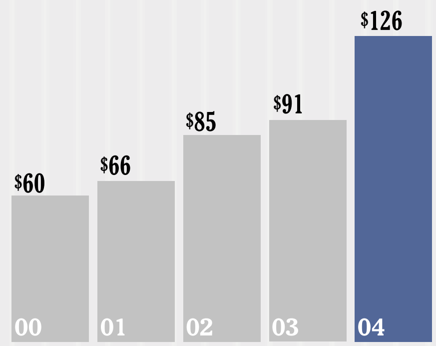
Trends
(dollars in billions)

to our shareholders



Mac Berryman
Chairman of the Board

F. A. (Andy) Lowrey
CEO & President



Distributions to Associations
(dollars in millions)

Cooperation is the hallmark of AgFirst's distinctive business model. Through cooperation, AgFirst and its affiliated associations provide superior loan products and financial services to farmers and ranchers, rural homeowners and agribusinesses. Through cooperation, AgFirst and associations develop processes and systems that make the delivery of those products and services more efficient. It is the cooperation between AgFirst and its 23 shareholder-associations that makes AgFirst successful—that makes us all successful.

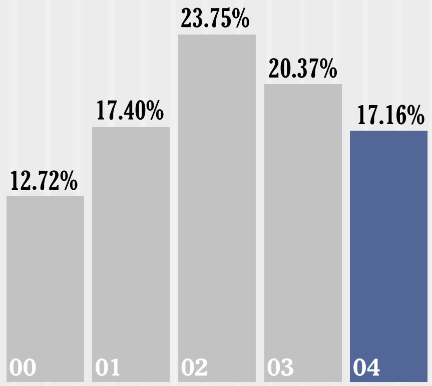
Cooperation was the foundation of the outstanding results that AgFirst delivered in 2004. Strong earnings and a record distribution to shareholders were the highlights of a year marked by many accomplishments.

2004 Financial Performance

Net income in 2004 totaled $180 million, up from $177 million the previous year. Meeting our goal to fund associations at or below the marginal cost of funds, AgFirst distributed a record $126 million to the associations. This amount represented almost 45% of the associations' combined net income and resulted in a 2.52% net average cost of funds for the associations.

Although strong farm income dampened loan demand, associations continued to grow, and their growth fueled ours. As a result, AgFirst's assets grew more than $1.0 billion in 2004 to a record $16.9 billion.

Despite weaknesses in certain sectors of the ag and general economies, our credit quality remained high in 2004. Associations reported 94.5% acceptable loans at year-end, the highest level reported in three years, and delinquencies were only 0.59% of associations' total loans at the close of the year, the lowest reported in three years.



Return on Shareholders' Equity

Strategic Initiatives

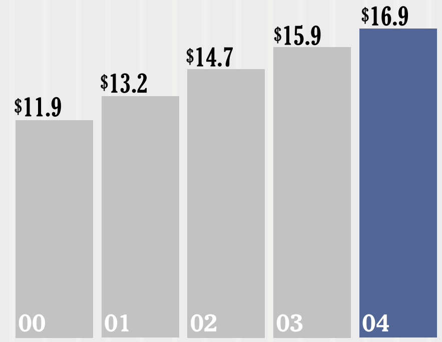
Cooperation is the basis of the strategic objectives that have guided AgFirst for several years. Our role is to provide superior funding, technology and other services to our member-associations, leaving them free to concentrate on their core competency of lending to agriculture and rural America. It is a common effort, resulting in a mutual benefit.

The efficiencies we've gained in recent years are an example of such a benefit. Through the improvements in technology AgFirst has provided, associations have been able to grow significantly without adding staff. Since 1997, AgFirst associations have added more than $5.0 billion in loan volume, while increasing staff by only 1.5%. This means more money is available to pay patronage refunds and fund the needs of rural America.

Strategically, we are focused on providing even more benefits to associations. That is why we spent a considerable amount of time meeting with them in 2004, discussing new ways to create efficiencies in association operations. Coming out of these discussions, we have formulated several "Business Integration Projects." These projects will address data integration, customer relationship management (CRM), workflow, and other measures that will position associations to serve their borrowers more efficiently and effectively.

Efficiency and effectiveness were also the drivers of a significant project we began in 2003 and implemented in 2004. Our conversion to a new financial accounting system, PeopleSoft's® Enterprise Financial Management software, was a complex task that involved considerable resources. Working side-by-side with our association partners, the project team delivered new, more efficient systems for general ledger, accounts payable, fixed assets, expense reporting, and time tracking.

We continue to seek ways to leverage our assets and spread our costs. Our focus on this initiative led us to developing a partnership with the Farm Credit of Bank of Texas in 2004. Working together, we helped the Texas bank implement and share the costs of our robust human resources system, the Lawson system, as well as our participation loan accounting system, ACBS. We are proud to say that our HR and ACBS implementation teams earned high marks from the staff at the Texas bank. We will continue to seek partnerships where we can bring value to both parties.



Total Assets
(dollars in billions)

Bringing value to rural America is an important part of the mission of the Farm Credit System. That is why we are committed to serving the rural housing industry. By being a key player in that market, we bring competitive rates to home buyers in rural areas. By building alliances with our affiliated associations and other mortgage originators throughout the United States, we bring liquidity to rural America and help fund its growth.

Serving Rural America

The mission of the Farm Credit System, as described in the preamble to the Farm Credit Act, is to "to provide for an adequate and flexible flow of money into rural areas." This is an honorable mission, a mission handed down to us through several generations, and one that we carry out with pride. With record distributions to our shareholder-associations, efficient funding for the loans they make in rural America, and cost-effective technology and other services, AgFirst delivered on that mission in 2004. Because this mission lives in the hearts of our board and staff, we'll do the same next year and for generations to come.

E. McDonald Berryman
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

Expertise is part of the value AgFirst brings to the table. "Their experience helps us meet these companies' needs quickly and efficiently."

Jeff Tyson, MidAtlantic Farm Credit.

Pennsylvania leads the nation in mushroom production, and most of the mushrooms grown in Pennsylvania are grown in Chester County, home of South Mill, a member of MidAtlantic Farm Credit.

John and Mike Pia own and operate South Mill, one of the largest growers and packers of fresh mushrooms in the United States. The company, which was started by their father in 1945, employs hundreds of workers who produce and ship more than 55 million pounds of mushrooms throughout the United States each year.

Business at South Mill is, if you'll pardon the pun, mushrooming. To help the company finance its growth, MidAtlantic Farm Credit and AgFirst's Capital Markets Group worked together as a team.

Such teamwork is not unusual. AgFirst partners with associations throughout the district to develop opportunities with large agribusinesses. According to Jeff Tyson of MidAtlantic, "We can serve customers like South Mill because AgFirst is standing behind us as a participation partner." Expertise is also part of the value AgFirst brings to the table. "AgFirst's Capital Markets Group has a great deal of experience in capital markets transactions," Tyson added, "and that experience helps us meet these companies' needs quickly and efficiently."

For Capital Markets officers like Tom Stallworth of AgFirst, working with associations and their customers is one of the most satisfying parts of the job. "When we partner with associations on such loans, the customer is the winner. They have a local lender who understands their business very well, and they have AgFirst and its network of system associations, commercial bank partners and other lenders competing to purchase their loan."

partnering

With associations to meet the needs of agribusinesses.

"Why," you might ask, "are these men wearing hairnets?" Quality is important to John and Mike Pia. Everyone who enters their mushroom packing facility must wear a hairnet, and lenders are no exception.

From the left are Mike Pia; Tom Stallworth, AgFirst; John Pia; and Jeff Tyson, MidAtlantic Farm Credit.

dedicated

To making dreams of home ownership a reality.

From the left are Reba Singley, AgFirst Secondary Mortgage Market; Billy and Polly Miller; and Ben Skelley, AgSouth Farm Credit. In the background Melody Miller.

Because of our partnership with Fannie Mae and Farmer Mac, our associations can offer competitive, affordable rates to their customers.

When Billy and Polly Miller were ready to build a house in the country, they checked around for the best rates and loan programs. Their search was complicated by the fact that they needed a house not only for themselves and their three children, but for their chickens, as well.

Billy and Polly have been growing broilers near Leesville, South Carolina, since 1996. They started their operation as part-time farmers—each had a full-time job off the farm—and took care of their broilers at nights and on weekends. When they decided to expand their poultry operation in 1999, they began looking for a new farm, a new home and a new lender.

Why did they choose Farm Credit? "We shopped around and talked to other lenders," said Polly, "but AgSouth Farm Credit had the best rates for our home and our broiler operation." Billy added, "They understood our operation and our goals; that's what they do for a living."

It's no accident that Billy and Polly got a great rate from Farm Credit on their beautiful new home in the country. At AgFirst, we believe that people who live in the country—farmers and non-farmers—deserve the same rates as those who live in urban areas. That's why AgFirst established its Secondary Mortgage Market Group in 1996. Because of our partnership with Fannie Mae and Farmer Mac, AgSouth and Farm Credit associations throughout the nation can offer competitive, affordable rates to people like the Millers.

"It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers…"

Section 1.1 of the Farm Credit Act.

Congress has long recognized that a "prosperous, productive agriculture" is critical to the United States, and it has relied upon farmers and farm organizations to tell them what farmers need in order to produce the food and other agricultural products our nation depends upon. In fact, that's what led to the creation of the Farm Credit Act.

In the early part of the twentieth century, farmers began telling their senators and congressmen that credit was scarce in rural areas. When credit was available, the terms didn't fit their needs; three to five years was simply not long enough to pay off a farm mortgage.

Congress listened and began looking for ways to address the credit needs of rural America. They appointed a commission to study successful farm cooperatives in Europe. The ideas they brought back to Washington became the foundation of a bill that established a system of farmer-owned, farmer-controlled financial cooperatives, the Farm Credit System.

Today, Congress still relies upon farmers and farm organizations to keep them informed. AgFirst and association board members regularly sponsor forums for communications: "fly-outs" for members of Congress and their staffs where they can meet face-to-face with farmers, and "fly-ins" where boards and management staff visit Washington to discuss current issues with their senators and representatives.

There are still unmet credit needs in rural America. To uncover those needs and suggest ways to address them, AgFirst is participating in the Farm Credit System's HORIZONS project. To gather information for this forward-looking planning initiative, we're talking to farmers and those who live and work in rural areas. Our work on HORIZONS will help ensure we continue to meet the changing needs of U.S. agriculture and rural America.

connected

To the leaders who understand the needs of rural America.

While in only his third year in the U.S. Senate, Senator Saxby Chambliss of Georgia was unanimously elected by his colleagues to serve as chairman of the U.S. Senate Committee on Agriculture, Nutrition and Forestry.

From the left are Bill Newberry, president, AgGeorgia Farm Credit; Senator Chambliss; and Dan Raines, member of the AgFirst Board of Directors and the board of AgGeorgia Farm Credit.

planning

For new and better ways to serve customers.

Planning is an annual event for the Farm Credit of Northwest Florida board.
From the left are Tom Welsh, executive vice president, AgFirst; Jimmy Ditty, chairman of the board, Farm Credit of Northwest Florida; and James Alberts, president, Farm Credit of Northwest Florida.

Good financial results don't just happen. It takes planning: a process of analyzing your business to determine where you are and where you need to go.

Planning can be hard work. It means digging deep into the "soul" of your organization to identify its strengths and weaknesses. It means assessing macro- and micro-economic conditions and forecasting their effects on your business; analyzing marketplace trends and predicting the needs of your customers; and, comparing your products, people, pricing, delivery channels—all aspects of your business—to that of your competition. Last but not least, it means deciding: deciding which new opportunities to pursue and what changes you need to make to grow and prosper.

Not surprisingly, it takes time and a lot of preparation to get ready for planning. You need accurate data and facts, surveys, and assessments. On planning day, you need a facilitator who is impartial, but who also understands your business well.

For years, AgFirst has helped association boards and management teams with the "heavy lifting" of planning. It's a value-added service that has helped associations throughout the district and the nation prepare for the future.

Planning has yielded valuable results for the associations we've served. It helped them recognize, years ago, the need for market segmentation, and that led to the development of better products and delivery methods for each segment. It also helped them recognize the emergence of "lifestyle farmers" as an important market segment; that led to the development of our successful "Country Mortgages" program.

In helping association boards and management teams with planning, AgFirst has benefited, as well. Our work with associations and their boards helps ensure we stay close to the needs of our customers and that their plans drive our plans. Planning is a "win-win-win" for AgFirst, associations and their customers.

It's a wonderful legacy we've been given: Farm Credit is the largest, oldest and most trusted agricultural lending organization in the United States. Standing behind every Farm Credit loan officer is our reputation as a responsible lender committed to agriculture and Rural America.

Our responsibility is to ensure that we pass this legacy on to capable hands. It's no secret that the baby-boom generation is nearing retirement. We know we must prepare the next generation to carry on Farm Credit's legacy of making sound, constructive loans. That's why, in 2004, AgFirst established "Farm Credit University."

New loan officers throughout the AgFirst District and the entire Farm Credit System attend Farm Credit University. At their local offices, students work through a progression of computer-based training modules, learning the fundamentals of credit and a host of other topics. Farm Credit University also trains their local mentors, seasoned loan officers who help them learn to make sound decisions. Students come together at mid-semester for "half-time training," an opportunity to meet face-to-face with experts in finance, marketing, business law and other disciplines.

When we envisioned Farm Credit University, we knew we wanted it to be the best it could be. That's why we selected as our "chancellor" one of the most respected agricultural finance and economics professors in the nation: Dr. David Kohl. A former professor of Agricultural Finance at Virginia Tech, Dr. Kohl is the author of Farm Credit University's training modules and one of the leaders of its "half-time training" sessions.

Dr. Kohl's energy and enthusiasm is infectious, and his students love him. (It's no wonder he has twice won the prestigious American Agricultural Economic Association's Outstanding Teaching award.) Through Farm Credit University, he's passing on his knowledge—and our collective knowledge—to the next generation of Farm Credit lenders. Our legacy is in good hands.

From the left are Dwight Rohrer, MidAtlantic Farm Credit; Curt Carlson, AgFirst; and Dr. David Kohl.

committed

To the future of Farm Credit and the people it serves.

2004 Financial Results

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (the Bank) 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 consolidated financial statements, and that the assets of the Bank 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 Bank 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 Audit Committee of the Board of Directors and to the Chief Executive Officer.

In 2004, AgFirst adopted a Code of Ethics for its Chief Executive Officer and Senior Financial Officers who are involved with preparation and distribution of financial statements and maintenance of the records supporting the financial statements. A copy of the AgFirst Code of Ethics may be viewed on the Bank's website at *www.agfirst.com*.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Bank 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 Bank. The undersigned certify that the 2004 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.

E. McDonald Berryman
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

Leon T. Amerson
Chief Financial Officer

March 4, 2005

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

as of December 31, 2004 *(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of AgFirst Farm Credit Bank (the Bank or AgFirst) for the years ended December 31, 2004, 2003 and 2002. This information should be read in conjunction with the accompanying consolidated financial statements, the Notes to the Consolidated Financial Statements and other sections of this annual report. See Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements for a discussion of the operations of AgFirst.

Financial Overview

The following information provides an overview, in capsule form, of AgFirst's financial results for 2004 as compared to 2003 and 2002:

- The aggregate principal amount of loans outstanding at December 31, 2004 was $12.9 billion compared to $12.4 billion at December 31, 2003, and $12.0 billion at December 31, 2002, reflecting increases of 4.03 percent and 7.50 percent compared to 2003 and 2002, respectively.
- Net income totaled $180.3 million for the twelve months ended December 31, 2004, reflecting a 1.61 percent increase and a 7.12 percent decrease compared to the years ended December 31, 2003 and 2002, respectively.
- The 2004 net income includes a $15.3 million reversal of the allowance for loan losses. This reversal, which positively affected income, was the result of the completion of previously announced study to refine the Bank's methodology for determining the allowance for loan losses.
- AgFirst's ratio of total shareholders' equity to total assets increased from 6.01 percent at December 31, 2003 and 5.15 percent at December 31, 2002 to 6.07 percent at December 31, 2004.
- AgFirst's return on average total assets and return on average shareholders' equity for the year ended December 31, 2004 were 1.11 percent and 17.16 percent, respectively, compared to 1.17 percent and 20.37 percent for the year ended December 31, 2003, and 1.43 percent and 23.75 percent for the year ended December 31, 2002.

Loans

AgFirst's loan portfolio primarily consists of direct notes receivable from affiliated Associations, loan participations purchased, and loans purchased through AgFirst's secondary mortgage market activities.

	2004	
	$	%
Direct Notes	$ 11,229,197	86.99%
Participations purchased, net	1,374,863	10.65
Secondary Mortgage	302,226	2.34
SFAS No. 133 Adjustment	63	—
Loans to Other Financing Institutions	1,900	.02
Total	$ 12,908,249	100.00%

	2003	
	$	%
Direct Notes	$ 10,592,325	85.59 %
Participations purchased, net	1,554,762	12.57
Secondary Mortgage	228,046	1.84
SFAS No. 133 Adjustment	(282)	—
Loans to Other Financing Institutions	500	—
Total	$ 12,375,351	100.00%

	2002	
	$	%
Direct Notes	$ 10,033,923	83.56 %
Participations purchased, net	1,631,311	13.59
Secondary Mortgage	344,383	2.87
SFAS No. 133 Adjustment	(2,176)	(.02)
Loans to Other Financing Institutions	600	—
Total	$ 12,008,041	100.00%

Loan growth came primarily through the direct notes that fund Association lending activity. Association growth was the result of their purchasing participations in addition to originations within their chartered territories. Association growth in originations is attributable to a seasoned lending staff, the value inherent to patronage paid under their cooperative structure, the direct and indirect payments on Program Crops under the current Farm Bill, an improving world economy coupled with a weaker dollar that helped boost agricultural exports, and borrowers seizing low interest rate opportunities.

Direct Notes

AgFirst's primary line of business is to provide funds to affiliated Associations. Each Association is a Federally chartered instrumentality of the United States and is regulated by the Farm Credit Administration (FCA). AgFirst has in place with each of the Associations, a revolving line of credit, referred to as a *direct note*. Each of the Associations funds most of its lending and general corporate activities by borrowing under its direct note. All assets of the Associations secure the direct notes, and lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association, including the subsidiaries of those Associations that have restructured as holding companies. (See Note 1, *Organization and Operations*, in the Notes to the Consolidated Financial Statements for further discussion.) Each GFA contains minimum liquidity, capital, and earnings requirements that must be maintained by the Association.

Although AgFirst's loans to the Associations are evidenced by direct notes that are with full recourse to the borrowing Associations, the Associations' ability to repay is, of course, significantly dependent upon repayment of loans made to their borrowers. Accordingly, AgFirst's direct and indirect credit exposure depends upon the creditworthiness of both the Associations that are direct borrowers and the underlying borrowers of the Associations as indirect borrowers of AgFirst.

AgFirst continually monitors the risk-bearing capacity of each Association through a variety of mechanisms, including testing of the reliability of the Association's credit classifications, periodic meetings

Management's Discussion & Analysis of Financial Condition & Results of Operations (continued)

with Association Management and Boards, semi-annual formalized risk assessments, and prior-approval of transactions that exceed the Association's delegated authority (which is determined by AgFirst). In addition, Associations are subject to an annual audit by independent auditors and periodic examination by the FCA.

All Associations exceeded the minimum GFA and regulatory requirements for liquidity, earnings, and capital as of December 31, 2004. No Association is operating under a supervisory action and the litigation in which Associations are involved is typically loan related and poses no material threat to their viability.

Associations employ a number of risk management techniques to limit credit exposures. Each Association has adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios and the Associations utilize guarantees from U.S. government agencies/departments, including the Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Service Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2004, Associations collectively had $1.2 billion under such government or Government Sponsored Enterprise (GSE) guarantee programs.

Each Association maintains an allowance for loan losses determined by its management and is capitalized based upon its unique situation. The following table illustrates the risk bearing capacity of the Associations.

	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Allowance/ Loans
High	24.12%	23.60%	1.97%
Mean	15.03%	11.85%	.61%
Low	12.23%	8.39%	.08%

The Associations serve all or a portion of fifteen states and Puerto Rico. This wide geographic dispersion is a natural risk-reducing factor for AgFirst. The following table illustrates the geographic distribution of the loan volume originated by the Associations.

State	2004	2003	2002
North Carolina	16 %	16%	17%
Florida	14	16	14
Georgia	13	12	12
Virginia	11	11	11
Pennsylvania	11	11	11
Maryland	7	7	6
South Carolina	6	7	7
Ohio	5	5	5
Alabama	3	3	3
Kentucky	3	3	3
Mississippi	2	2	2
West Virginia	2	2	2
Delaware	2	2	2
Louisiana	2	1	2
Puerto Rico	2	1	2
Tennessee	1	1	1
Total	100 %	100%	100%

Only five states have loan volume representing more than 10 percent of the total. Commodity diversification, guarantees, and borrowers with relatively high levels of non-farm income mitigate the geographic concentration risk in these states.

During the third quarter of 2004, a series of five hurricanes caused damage across the AgFirst District. Florida, Puerto Rico, and parts of Georgia, Alabama and North Carolina were the areas most impacted. In certain areas, crop commodity damage was severe, but no long-term negative impact is anticipated. It is anticipated for the risk of loss to be mitigated by insurance proceeds, disaster relief and the overall financial health of the borrowers' balance sheets.

Credit quality within the combined Associations' portfolios improved during the twelve months ended December 31, 2004. At year-end, the combined Associations' net loans were classified as follows:

	2004	2003	2002
Acceptable	94.50%	92.72%	92.54%
OAEM	3.43	4.96	4.95
Adverse	2.07	2.32	2.51
Total	100.00%	100.00%	100.00%

Other Assets Especially Mentioned (OAEM) loans assets are considered fully collectible but have potential weaknesses. Adverse loans include substandard, doubtful, and loss loans.

Delinquencies were 0.59 percent of Association total loan assets at year-end 2004 compared to 0.73 percent and 0.81 percent at year-end 2003 and 2002, respectively. Nonperforming assets for the combined Associations represented 0.64 percent of total loan assets or $84 million, compared to 0.73 percent or $92 million for 2003, and 0.80 percent or $95 million for 2002. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

Net chargeoffs of $3.9 million, $3.1 million and $13.2 million were recorded in 2004, 2003, and 2002, respectively. As a percentage of total loan assets, net chargeoffs for the combined Associations were 0.03 percent for 2004 compared to 0.02 percent and 0.11 percent in 2003 and 2002, respectively.

Although the Farm Credit System receives no direct government support, credit quality is an indirect beneficiary of government support, as government program payments to borrowers enhance their ability to honor their commitments. However, due to the geographic location of the District and the resulting types of agriculture, government programs account for a relatively small percentage of net farm income in the territory served by the Associations. In addition, the diversified nature and significant non-farm influence on the District's portfolio mitigate the impact of government support for program crops.

Earnings for the combined Associations totaled $478.4 million, $231.6 million, and $202.4 million, producing an average return on assets of 3.65 percent, 1.85 percent, and 1.77 percent, and an average return on equity of 24.35 percent, 12.26 percent, and 10.67 percent for 2004, 2003, and 2002, respectively. Association earnings increased $246.8 million for the period ended December 31, 2004 compared to 2003.

Included in the 2004 results was a one-time reversal of the allowance for loan losses of $188.9 million, net of $11.2 million tax impact, in connection with completion of previously announced studies to refine the System institutions' methodologies for determining the allowance for loan losses. Excluding the one-time reversal of the allowance for loan losses, net income for the combined Associations would have been $289.5 million for 2004. The portion of net income resulting from the reversal of the allowance for loan losses was retained in capital and has minimal impact on the combined Associations' overall risk funds (total capital plus allowance for loan losses). During 2004, the combined Associations' risk funds, a measure of risk-bearing capacity, increased $166 million to $2,330 million, which represents 18 percent of combined Association loans.

AgFirst provides each Association with core operating systems and support, including a loan origination system, loan accounting and servicing systems, general ledger and related financial accounting systems, and a human resources/payroll system. With AgFirst providing such systems, the Associations are able to achieve efficiencies ordinarily afforded only to much larger organizations. In addition, having common systems supported by AgFirst provides an opportunity to automate the AgFirst/Association lending process. One of the most significant advantages of this is a match-funding mechanism that automatically creates direct note advances that match the repricing and maturity characteristics of each underlying loan. By employing this system, interest rate risk is significantly reduced at the Associations.

The diversity of income sources supporting Association loan repayment mitigates credit risk to AgFirst. The Associations' credit portfolios are comprised of a number of segments having varying agricultural characteristics. The following table/chart illustrates the aggregate credit portfolio of the Associations by major commodity segments.

	Percent of Portfolio		
Commodity Group	**2004**	**2003**	**2002**
Poultry	13%	13%	13%
Forestry	12	12	11
Cattle	9	9	8
Fruits/Vegetables	9	5	5
Grain	8	10	9
Dairy	8	8	7
Nursery/Greenhouse	5	5	5
Processing	4	4	5
Rural Home	4	4	4
Tobacco	4	4	4
Swine	3	3	4
Cotton	3	3	4
Citrus	2	3	4
Other	16	17	17
Total	100%	100%	100%

The table illustrates that 2004 commodity concentrations were 5 percent or more in only seven segments. The concentration in these segments is mitigated by a prevalence of non-farm income among the borrowers as demonstrated by the following table, which segregates part-time farm loans into a unique segment.

	Percent of Portfolio		
Commodity Group	**2004**	**2003**	**2002**
Part-time Farmers	46%	46%	45%
Poultry	11	11	11
Dairy	7	8	7
Forestry	5	4	4
Nursery/Greenhouse	4	4	3
Grain	4	3	5
Cattle	3	3	3
Cotton	3	3	3
Swine	3	3	3
Tobacco	3	3	3
Other	11	12	13
Total	100%	100%	100%

Associations have concentrations of full-time farmers greater than 5 percent in only two commodities-poultry and dairy. Both poultry and dairy have a large geographic dispersion with production over the entire AgFirst footprint. Concentrations within the Associations are further dispersed through the number of farm units producing poultry or dairy products. Poultry production is almost exclusively done through a network of contract growers whose income remains stable because the variable costs are absorbed by the contracting integrators. Poultry concentration is further disbursed as production is segregated among chicken, turkey, and egg production. Dairy herds range in size from less than 100 cows to approximately 10,000. Associations also manage their credit and concentration risk through participations, guarantees, and direct payment assignments from the poultry integrators and milk processing facilities. Also many producers have significant secondary income from off-farm employment by a family member.

Individual loan exposures totaling $5 million or greater, which represent the commercial and corporate side of agribusiness, comprise approximately 14 percent of Association loan volume. As mentioned above, loans exceeding an Association's delegated lending authority must be pre-approved by AgFirst. As a result, larger agribusiness loans are typically analyzed by AgFirst's commercial lending staff as well as an Association's own lending staff prior to an Association committing to such loans.

Approximately 66 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $100 thousand make up 24 percent of loan volume. This diversification among borrowers is another key component of the Associations' stable credit quality and solid financial performance over time. Associations have very little volume that is not collateralized. Typically short and long-term loans are cross-collateralized and cross-defaulted. By law, all long-term loans must be secured by a first lien on real estate with a loan to appraised value not exceeding 85 percent. As of December 31, 2004, 55 percent of the Association loans were identified as long-term loans. Therefore, exposure to losses is minimized through collateralization.

Participations/Syndications

AgFirst has an active Capital Markets Unit that purchases and sells large loan participations and syndications. The Capital Markets Unit works with the Associations to originate loans within the

Management's Discussion & Analysis of Financial Condition & Results of Operations (continued)

District's territory, providing commercial loan expertise to augment the Associations' staffs, as needed, as well as providing an outlet for loans that exceed an Association's exposure limits. Additionally, the Capital Markets Unit actively pursues the purchase of participations and syndications originated outside of the District's territory. These loans may be held as earning assets of AgFirst or sub-participated to the Associations. The Capital Markets Unit also sells participations outside of the District to manage its own concentrations. Refer to the *Recent Regulatory Matters* discussion at the end of this section.

The AgFirst Participation/Syndication portfolio average outstanding volume for the twelve months ended December 31, 2004 totaled $1.299 billion, which reflects a decrease of $96 million or 7 percent, compared to 2003. The following table shows credit exposures as of December 31.

	2004	2003	2002
Participations Purchased	$ 1,676,940	$ 1,898,309	$ 1,953,302
Less: Participations Sold	302,077	343,547	321,991
Net Outstanding	1,374,863	1,554,762	1,631,311
Available Commitment	1,086,958	855,727	891,048
Letters of Credit and Guarantees	146,579	239,211	212,588
Total Exposure	$ 2,608,400	$ 2,649,700	$ 2,734,947

Like the Associations, AgFirst employs a number of risk management techniques to limit credit exposures. AgFirst has adopted risk management techniques such as underwriting standards, individual borrower exposure limits, commodity exposure limits, and various other credit risk management techniques. To achieve a more diversified portfolio, AgFirst is also actively involved in the purchase and sale of participation loans.

The following tables illustrate AgFirst's participation/syndication portfolio by geographic distribution and major commodity segments:

	2004		2003		2002	
	$	%	$	%	$	%
Florida	$ 291,437	21%	$ 278,446	18%	$ 284,173	17%
North Carolina	149,917	11	192,324	12	246,682	15
South Carolina	108,621	8	129,686	8	98,385	6
Georgia	84,864	6	79,333	5	78,568	5
Texas	72,553	5	76,494	5	98,936	6
Virginia	70,733	5	75,480	5	102,229	6
Missouri	65,944	5	78,580	5	83,479	5
Pennsylvania	64,792	5	80,997	5	82,564	5
New York	60,450	4	85,467	6	54,063	3
Minnesota	59,544	4	94,138	6	66,492	4
Delaware	47,854	4	36,506	2	19,906	1
California	30,608	2	35,677	2	81,791	5
Ohio	27,146	2	30,603	2	44,920	3
Illinois	24,759	2	24,515	2	62,075	4
Colorado	23,076	2	17,880	1	9,384	1
Other	192,565	14	238,636	16	217,664	14
Total	$ 1,374,863	100%	$ 1,554,762	100%	$ 1,631,311	100%

The higher geographic concentrations in Florida and North Carolina are attributed to large commodity concentrations in the sugar and citrus industries in Florida and in the poultry, meat and swine industries in North Carolina. Concentration risk is mitigated through established hold positions to a single borrower and to a single commodity/industry.

Volume outstanding in AgFirst's participation/syndication portfolio decreased by 11.6 percent from 2003 year end to 2004 year end. The decline was attributable to these factors:

- Less usage on the lines of credits. It is noteworthy that AgFirst reflected some growth in the total commitments in 2004, but usage of committed credit facilities declined. Excellent profitability of many commodity sectors producing robust cash flow and continued restraint in capital spending have contributed to reduced usage of credit facilities;
- Increased competition for loans by commercial lenders, institutional investors and other Farm Credit institutions trying to deploy their capital in an economy awash with liquidity;
- Refinancing activity causing existing loan liquidation, and voluntary selling of some loan assets; and
- The negative impact of FCA's ruling on syndications dated February 24, 2004, which limits growth opportunities.

Most of the commodities/industries within the portfolio are performing well, which should produce some internal volume growth over time. AgFirst's calling program is beginning to generate opportunities to purchase new credit as well as maintain our allocations in existing credits.

	Percent of Portfolio		
Commodity Group	**2004**	**2003**	**2002**
Food and Kindred Products	22%	17%	14%
Agribusiness	11	14	12
Electric Utilities	10	11	13
Forestry	10	9	8
Sugar Cane/Sugar Beets	9	9	8
Citrus	6	6	7
Poultry & Eggs	6	5	6
Swine	5	6	7
Telephone Utilities	5	7	9
Horticulture	4	3	5
Other	12	13	11
Total	100%	100%	100%

Food and kindred products consist of beef, hogs, turkeys, broilers, and multiple meat slaughtering/processing, dairy products, canned, frozen, preserved fruits and vegetables, rice milling and further processing, soybean oil and meal mills, and wine and beverages. The increase in food and kindred products is attributed to loans to the wine, canned fruit & vegetable, milling, and turkey processing sectors.

Credit quality at year-end 2004 reflected improvement. At December 31, 2004, fully acceptable volume was 93.82 percent compared to 92.94 percent and 91.74 percent for 2003 and 2002, respectively. The OAEM category was 2.75 percent, 3.66 percent, and 4.94 percent for years ended 2004, 2003, and 2002, respectively. Substandard volume decreased to 2.66 percent in 2004 from 2.78 percent in 2003, and from 3.33 percent in 2002. Doubtful volume at year-end 2004 consisted of one loan representing 0.77 percent of total outstanding volume.

Secondary Mortgage Market Loans

AgFirst operates a Secondary Mortgage Market Unit (SMMU) to facilitate the purchase and sale of loans in the secondary market. Loans purchased by the SMMU to be "held to maturity" are generally guaranteed by Fannie Mae and/or Farmer Mac, thereby exposing AgFirst to limited credit risk. Technically, the guarantees are in the form of *Long-Term Standby Commitments to Purchase*, which give AgFirst the right to deliver delinquent loans to the "guarantor" at par.

The table below illustrates the SMMU gross unpaid principal balance of loans outstanding at December 31, 2004, 2003 and 2002.

(dollars in millions)	2004		2003		2002	
Rural Home Loans - Guaranteed	$ 145.3	48%	$ 18.2	8%	$ 166.5	48%
Part-time Farm Loans - Guaranteed	115.7	38	110.6	48	83.0	24
Agricultural Loans - Guaranteed	3.5	1	4.4	2	3.2	1
Non-guaranteed Loans	38.2	13	95.1	42	92.4	27
Total	$ 302.7	100%	$ 228.3	100%	$ 345.1	100%

Rural home loans are loans that conform to Fannie Mae underwriting standards and are guaranteed by Fannie Mae and Farmer Mac. These loans, which are readily marketable, are held by AgFirst as "available for sale." During 2004, AgFirst purchased $359.6 million of rural home and part-time farm loans, but sold $256 million. Net losses on the sale of these loans totaled $2.4 million in 2004. Purchases of rural home and part-time farm loans averaged $30 million per month for 2004.

The $115.7 million in *part-time farm loans* represent first lien mortgages on homes with property characteristics (such as acreage or agricultural improvements) that conform to Farmer Mac standards. These loans are guaranteed by Farmer Mac and are accounted for as "held-to-maturity."

AgFirst owns $3.5 million of *agricultural loans* that are guaranteed by Farmer Mac. This segment is small, due primarily to the Associations' propensity to hold agricultural loans in-portfolio. Through AgFirst, a number of Associations obtain Farmer Mac guarantees for qualifying segments of their agricultural portfolios, thereby eliminating the need to sell those loans to the Bank.

The $38.2 million of *non-guaranteed loans* generally consists of loans that are being held for eventual delivery to, or guarantee by, Fannie Mae or Farmer Mac. All such loans are secured by first-lien mortgages and are considered high quality assets.

AgFirst services the loans that it purchases, and typically retains servicing on loans sold. The total volume being serviced as of December 31, 2004 was $1.6 billion, with the servicing asset valued at $9.9 million.

Accounting Developments Related to the Allowance for Loan Losses

During 2004, the Bank completed its study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines. As a result of this study and the resulting refinements in methodology, during the fourth quarter of 2004, the Bank recorded a $15,292 reversal of the allowance for loan losses.

The Bank allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account the credit losses experienced in the mid-to-late 1980s, as a result of unusually adverse economic factors affecting American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Bank allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Bank allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include, among others, an assessment of probable losses, historical loss experience and economic conditions.

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

The refinement in methodology resulted in a calculated allowance for loan losses that were significantly less than the previously recorded balance due to 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 levels of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Bank considered the following when adjusting the historical charge-offs experience:

- Credit risk classifications,
- Collateral values,
- Risk concentrations,
- Weather related conditions, and
- Economic conditions.

While the $15.3 million reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant

Management's Discussion & Analysis of Financial Condition & Results of Operations (continued)

impact on the level of the risk bearing capacity of AgFirst. "Risk funds" (capital plus the allowance for loan losses), totaled $1,039 million at December 31, 2004 (8.05 percent of Bank loans), as compared with $989 million at December 31, 2003 (7.99 percent of Bank loans) and $788 million at December 31, 2002 (6.56 percent of Bank loans).

The following table provides relevant information regarding the allowance for loan losses for AgFirst at December 31.

	Year Ended December 31, 2004	2003	2002
Balance at beginning of year	$ 34,168	$ 31,155	$ 25,616
Provision for Loan Losses	—	2,500	8,000
Nonrecurring provision for loan loss reversal	(15,292)	—	—
Loans charged off	(4,098)	(67)	(2,522)
Recoveries	22	580	61
Balance at end of year	$ 14,800	$ 34,168	$ 31,155
Allowance for loan losses to loans	.11%	.28%	.26%
Allowance for loan losses to nonaccrual loans	56.00%	108.76%	132.22%
Allowance for loan losses to participation loans & SMMU loans	1.05%	2.08%	1.81%

Please refer to Note 5, *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

AgFirst net income totaled $180,306 for the year ended December 31, 2004, an increase of $2,857 from 2003 and a decrease of $13,827 from 2002. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

	Year Ended December 31, 2004	2003
Net income (for prior year)	$ 177,449	$ 194,133
Increase (decrease) due to:		
Total interest income	15,790	(78,862)
Total interest expense	(48,252)	67,259
Net interest income	(32,462)	(11,603)
Provision for loan losses	17,792	5,500
Noninterest income	8,508	(14,758)
Noninterest expense	9,019	4,177
Total increase (decrease) in net income	2,857	(16,684)
Net income	$ 180,306	$ 177,449

Interest Income

Total interest income for the year ended December 31, 2004 was $544,339, an increase of $15,790 as compared to the same period of 2003. Total interest income for 2003 was $528,549, a decrease of $78,862 as compared to the same period of 2002. The increase from 2003 to 2004 is primarily attributed to increases in average earning assets. The decrease from 2002 to 2003 is primarily attributed to the declining rates offset to some extent by an increase in average earning assets.

The following table illustrates the impact that volume and yield changes had on interest income over these periods.

	Year Ended December 31, 2004-2003	2003-2002
Increase in average earning assets	$ 980,296	$ 1,613,328
Average yield (prior year)	3.51%	4.52%
Interest income variance attributed to change in volume	34,452	72,989
Average earning assets (current year)	16,019,579	15,039,283
Increase (decrease) in average yield	(.12)%	(1.01)%
Interest income variance attributed to change in yield	(18,662)	(151,851)
Net change in interest income	$ 15,790	$ (78,862)

Interest Expense

Total interest expense for the year ended December 31, 2004 was $332,744, an increase of $48,252 as compared to the same period of 2003. Total interest expense for the year ended December 31, 2003 was $284,492, a decrease of $67,259 as compared to the same period of 2002. The increase in interest expense from 2003 to 2004 is primarily attributed to an increase in interest-bearing liabilities supporting asset growth and the impact of Statement of Financial Accounting Standards (SFAS) No. 150, discussed below. The decrease from 2002 to 2003 is attributable to declining interest rates and the issuance of preferred stock, discussed below, offset somewhat by increasing interest-bearing liabilities supporting asset growth and the impact of SFAS No. 150.

Prior to the adoption of SFASs No. 150, *Accounting for Certain Financial Instruments with both Characteristics of Liabilities and Equity,* which states that mandatorily redeemable financial instruments are classified as liabilities, dividends on preferred stock were reflected as an adjustment to capital and not as expense. As a result, the issuance of $225,000 of mandatorily redeemable preferred stock in 2001 and $150,000 of perpetual preferred stock in 2003 resulted in a decrease in interest expense, as the proceeds from the stock issuances were used to pay down debt.

With the adoption of SFAS No. 150 on July 1, 2003, dividends on mandatorily redeemable preferred stock are required to be reflected prospectively as interest expense. As a result, $9,442, which represents dividends from July 1, 2003 to December 31, 2003 on the $225,000 mandatorily redeemable preferred stock, was reflected as interest expense rather than an adjustment to capital. In 2004, the related interest expense was $18,884.

The following table illustrates the impact that volume and rate changes had on interest expense over these periods.

	Year Ended December 31, 2004-2003	Year Ended December 31, 2003-2002
Increase in average interest-bearing liabilities	$ 787,349	$ 1,785,172
Average rate (prior year)	2.00%	2.82%
Interest expense variance attributed to change in average interest-bearing liabilities	15,723	50,390
Average interest-bearing liabilities (current year)	15,034,085	14,246,736
Increase (decrease) in average rate	0.21%	(0.82%)
Interest expense variance attributed to change in rate	32,529	(117,649)
Net change in interest expense	$ 48,252	$ (67,259)

Net Interest Income

Net interest income declined from 2002 to 2003 and from 2003 to 2004, as illustrated by the following table:

Analysis of Net Interest Income

	2004		2003		2002	
	Avg. Balance	**Interest**	**Avg. Balance**	**Interest**	**Avg. Balance**	**Interest**
Loans	$ 12,464,633	$ 469,774	$ 12,058,243	$ 469,148	$ 11,489,521	$ 544,575
Cash & Investments	3,554,946	74,565	2,981,040	59,401	1,936,435	62,836
Total Earning Assets	$ 16,019,579	$ 544,339	$ 15,039,283	$ 528,549	$ 13,425,956	$ 607,411
Interest-Bearing Liabilities	$ 15,034,085	$ (332,744)	$ 14,246,736	$ (284,492)	$ 12,461,564	$ (351,751)
Impact of Capital	$ 985,494		$ 792,547		$ 964,392	
Net Interest Income		$ 211,595		$ 244,057		$ 255,660

	2004 Average Yield	2003 Average Yield	2002 Average Yield
Yield on Loans	3.77%	3.89%	4.74%
Yield on Cash & Investments	2.10%	1.99%	3.24%
Yield on Earning Assets	3.40%	3.51%	4.52%
Cost of Interest-Bearing Liabilities	2.21%	2.00%	2.82%
Spread	1.19%	1.51%	1.70%
Impact of Capital	.13%	.11%	.21%
Net Interest Income/Avg. Earning Assets	1.32%	1.62%	1.91%

Management's Discussion & Analysis of Financial Condition & Results of Operations (continued)

The Bank's average spread declined by 32 basis points compared to 2003. Net interest income (and spread) in 2002 was positively impacted by AgFirst's ability to exercise call options on debt during the decline in interest rates, effectively lowering its cost of funds relative to the assets, which did not prepay as quickly. The spread was expected to return to more normal levels through time, as asset prepayments "catch up" to called debt levels or as the assets and underlying funding mature or reprice in the normal course of business. The decline in spread reflects the anticipated "return toward normalcy."

Provision for Loan Losses

The Bank assesses risks inherent in its portfolio on an ongoing basis and establishes an appropriate reserve for loan losses. As referenced above, the $15.3 million reversal in 2004 resulted from the AgFirst study, and the resulting refinements in methodology completed during the fourth quarter of 2004. Provisions of $2,500 and $8,000 in 2003 and 2002, respectively, represented the establishment of reserves in response to deterioration in certain discreet loans and loan segments.

Noninterest Income

Noninterest income for the year ended December 31, 2004 was $18,021, an increase of $8,508 compared to 2003. The increase in 2004 was primarily the result of the $2,895 increase in loan fees, the $3,098 increase in gains on sales of investments, and the $3,757 gain on the sale of stock of the Farm Credit Leasing Corporation. Noninterest income for the year ended December 31, 2003 was $9,513, a decrease of $14,758 compared to 2002. The decrease in 2003 was primarily due to a decrease in secondary mortgage operations income, partially offset by an increase in realized gains on investments. During 2004 and 2003, AgFirst recorded losses of $927 and $6,729, respectively, in secondary mortgage operations compared to $13,992 in secondary mortgage operations income in 2002.

SMMU operations income (loss) consisted of the following:

	Year Ended December 31, 2004	2003	2002
Servicing income	$ 3,523	$ 3,014	$ 1,495
Gain (loss) on sale of loans	(2,445)	(1,859)	14,301
Amortization of servicing rights	(3,808)	(5,284)	(1,804)
Impairment (recovery of impairment) of servicing assets	1,803	(2,600)	—
Total SMMU income (loss)	$ (927)	$ (6,729)	$ 13,992

Noninterest Expense

Noninterest expense for the year ended December 31, 2004 was $64,602, a decrease of $9,019 as compared to the same period of 2003, and a decrease of $13,196 compared to 2002.

The following table illustrates the sources of variance:

	Year Ended December 31, 2004	2003
Prior Year Noninterest Expense	$ 73,621	$ 77,798
Change in Expense:		
Salaries and employee benefits	2,805	860
Occupancy and equipment	1,271	586
Intra-System financial assistance expense	(6,514)	(2,150)
Insurance fund premium	(1,169)	1,382
Other operating expenses	2,360	(2,897)
Called debt expense	(8,376)	(1,782)
Miscellaneous	604	(176)
Noninterest Expense	$ 64,602	$ 73,621

Salaries and employee benefits have trended up over the two-year period. The substantial increase from 2003 to 2004 was heavily influenced by higher salaries expense with lower salaries capitalization for projects and increasing benefits expense. Weak investment performance and lower discount rates resulted in higher pension expense. Lower discount rates and increasing healthcare trends had a similar impact on post-retirement healthcare expense. AgFirst, along with other participating Associations, adopted changes to their respective benefits plans effective January 1, 2003, in an effort to moderate future increases.

Occupancy and equipment expenses increased during 2003 and 2004, primarily the result of a technology renovation aimed at improving AgFirst's technical infrastructure and updating various systems.

Financial assistance expense declined in 2003 and 2004 due to the retirement of several Financial Assistance Corporation bonds. See Note 12, *Intra-System Financial Assistance,* in the Notes to the Consolidated Financial Statements for further information. AgFirst will fully extinguish its obligations in 2005 with the maturity of the last Financial Assistance Corporation bonds.

The Farm Credit System Insurance Corporation (FCSIC) targets a secure base amount equal to 2 percent of System obligations. FCSIC premiums decreased in 2004 in response to the lower-than-anticipated growth in System obligations. This resulted in lowering the rate to 0.05 percent in 2004, compared to 0.12 percent of retail loans outstanding in 2003. In 2003, growth throughout the System resulted in the secure base amount decreasing relative to obligations – leading to a premium increase from 0.03 percent in 2002 to 0.12 percent of retail loans outstanding in 2003.

Other operating expenses decreased $2,897 from 2002 to 2003, and increased $2,360 from 2003 to 2004. The increase from 2003 to 2004 was primarily the result of professional fees paid for consultants' assistance related to AgFirst's compliance with new System disclosure and governance practices. Purchased services for professional fees increased $3,162 for the twelve months ended December 31, 2004, compared to 2003. The decrease from 2002 to 2003 was primarily the result of the capitalization of purchased service expenses related to implementation of new financial systems.

Unamortized concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. As of December 31, 2004, the called debt expense was $3,360, a decrease of $8,376, compared to the comparable period in 2003. Falling interest rates in 2003 enabled AgFirst to call a substantial amount of debt resulting in the called debt expense of $11,736. Called debt volume was $2.5 billion, $8.6 billion and $13.2 billion for 2004, 2003 and 2002, respectively. Stable-to-rising rates in 2004 significantly reduces call opportunities.

Liquidity and Funding Sources

AgFirst maintains adequate liquidity to satisfy its daily cash needs. In addition to normal cash flow associated with lending operations, AgFirst has two primary sources of liquidity: investments and the issuance of Systemwide Debt Securities.

Investments, Cash and Cash Equivalents

FCA Regulations provide that a Farm Credit Bank may hold certain eligible investments, in an amount not to exceed 30 percent of its total loans outstanding, to satisfy FCA's liquidity reserve requirement, manage surplus short-term funds, and manage interest rate risk. AgFirst maintains an investment portfolio comprised primarily of short-duration, high-quality investments. The high-quality, short-duration nature of the portfolio guarantees that investments can be converted to cash quickly, without significant risk of loss.

Investment securities and cash equivalents outstanding as of December 31, 2004 for AgFirst totaled $3.72 billion compared to $3.30 billion and $2.50 billion at December 31, 2003 and 2002, respectively.

AgFirst's investment portfolio consisted of the following security types as of December 31, 2004:

	2004		2003		2002	
Investment securities						
Commercial Paper	$ 29,957	1%	$ 229,879	7%	$ 259,820	10%
U.S. Govt. GNMA MBS/CMOs	1,080,843	29	911,176	28	826,576	33
U.S. Govt. Agency MBS	1,853,148	50	1,634,415	50	960,268	38
Non-Agency WholeLoans	292,545	8	20,275	1	37,899	2
Commercial MBS	—	—	1,717	—	3,236	—
Asset-backed Securities	21,921	—	35,254	1	65,319	3
Total Investment Securities *	3,278,414	88	2,832,716	87	2,153,118	86
Cash Equivalents						
Fed Funds	58,691	2	108,700	3	75,691	3
Master Notes	107,000	3	109,935	3	117,000	5
Repos	275,000	7	250,000	7	150,000	6
Total Cash Equivalents	440,691	12	468,635	13	342,691	14
Total Investment Portfolio	$ 3,719,105	100%	$ 3,301,351	100%	$ 2,495,809	100%

* *As shown on the Consolidated Balance Sheet, excluding cash equivalents.*

Management's Discussion & Analysis of Financial Condition & Results of Operations (continued)

As illustrated, in 2004, money market instruments (Commercial Paper, Fed Funds, Master Notes and Repos) represented 12 percent of the portfolio. U.S. Government and Agency-guaranteed mortgage securities made up an additional 80 percent of the portfolio. The remaining 8 percent of the portfolio, while not Government or Agency-guaranteed, consisted of highly rated, liquid securities.

AgFirst, in conjunction with the other System Banks, has adopted a liquidity policy that established a "minimum coverage" level of 90 days. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2004, AgFirst's coverage was 173 days.

Systemwide Debt Securities

The primary source of funds for AgFirst is the issuance of Systemwide Debt Securities through the Federal Farm Credit Banks Funding Corporation. At December 31, 2004, AgFirst had $15.4 billion in total debt outstanding compared to $14.5 billion at December 31, 2003 and $13.5 billion at December 31, 2002. The year-to-year increases were primarily due to the increases in loan volume and investments. Refer to Note 8, *Bonds and Notes*, for additional information related to debt.

Asset/Liability Management

AgFirst adheres to a philosophy that all loans should be priced competitively in the market and that loan rates and spreads should be contractually established at loan closing such that a borrower is not subject to rate changes at the discretion of management or boards of directors. Therefore, all District Association variable rate and adjustable rate loans are indexed to market rates, and fixed rate loans are priced based on market rates at closing. Loan products offered by the Associations include prime-indexed variable rate loans, LIBOR-indexed variable rate loans, one-, three- and five-year Treasury-indexed adjustable rate loans, and fixed rate loans. Variable rate and adjustable rate loans are offered with or without caps. Terms are available for up to 30 years. A variety of repayment options are offered, with the ability to pay on a monthly, quarterly, semi-annual or annual frequency. In addition, "custom" repayment plans may be negotiated to fit a borrower's unique circumstances.

The objective of the AgFirst asset/liability management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst's interest-earning assets and interest-bearing liabilities and simulation analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates. The following tables represent AgFirst's projected change in net interest income and market value of equity for various rate movements as of December 31, 2004.

Net Interest Income

Scenarios	Net Interest Income	% Change
+400 BP Shock	$179,744	(1.36%)
+200 BP Shock	$176,669	(3.05%)
0 BP	$182,224	—
-50% 3M Tbill*	$199,988	9.75%

Market Value of Equity

Scenarios	Assets	Liabilities	Equity	% Change
Book Value	$16,619,585	$15,755,210	$864,375	—
+400 BP Shock	$15,446,477	$14,935,184	$511,293	(34.14%)
+200 BP Shock	$15,968,960	$15,530,316	$648,644	(16.44%)
0 BP	$16,497,849	$15,721,548	$776,301	—
-50% 3M Tbill*	$16,761,039	$15,908,731	$852,308	9.79%

* *When the three-month Treasury bill interest rate is less than 4 percent, both the minus 200 and minus 400 basis point shocks are replaced with a downward shock equal to one-half of the three-month Treasury bill rate.*

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2004. The amount of assets and liabilities shown, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

	Repricing/Maturity Gap Analysis			
	Less than or Equal to 1 Year	**Greater than 1 Year Less than 5 Years**	**Greater than or Equal to 5 Years**	**Total**
Short and Intermediate-Term Loans				
Fixed	$ 918,257	$ 30,038	$ 87,177	$ 1,035,472
Variable	4,838,082	—	—	4,838,082
Total Short and Intermediate-Term Loans	5,756,339	30,038	87,177	5,873,554
Long-Term Real Estate Loans				
Fixed	2,251,562	3,014,142	1,567,333	6,833,037
Variable	174,789	26,575	294	201,658
Total Long-Term Real Estate Loans	2,426,351	3,040,717	1,567,627	7,034,695
Total Loans	8,182,690	3,070,755	1,654,804	12,908,249
Cash and Investments	3,166,237	372,694	209,741	3,748,672
Total Interest Earning Assets	$ 11,348,927	$ 3,443,449	$ 1,864,545	$ 16,656,921
Source of Funds				
Interest Bearing Liabilities	$ 8,864,385	$ 5,197,000	$ 1,341,000	$ 15,402,385
Mandatorily Redeemable Preferred Stock	—	—	225,000	225,000
Perpetual Preferred Stock	—	—	150,000	150,000
Interest Rate Swaps	1,040,000	(1,040,000)	—	—
Equity	—	—	879,536	879,536
Total Source of Funds	$ 9,904,385	$ 4,157,000	$ 2,595,536	$ 16,656,921
Interest Rate Sensitivity Gap	$ 1,444,542	$ (713,551)	$ (730,991)	
Sensitivity Gap as a % of Total Earning Assets	8.67%	(4.28%)	(4.39%)	
Cumulative Gap	$ 1,444,542	$ 730,991	$ —	
Cumulative Gap as a % of Total Earning Assets	8.67%	4.39%	—	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.15	.83	.72	

Over the last year, flattening yield curves have resulted in over $1.1 billion of callable bonds moving "out of the money," effectively extending their duration, and resulting in the $1.445 billion asset sensitive position in the first tranche. The sensitivity analysis above, however, suggests that if rates rise, asset maturities will lengthen more than liabilities thereby leading to a slightly liability sensitive position.

At December 31, 2004, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.855 billion and purchased interest rate caps with notional amounts totaling $1.806 billion. These derivative transactions were executed to reduce interest rate risk and/or reduce funding costs.

AgFirst policy prohibits the use of derivatives for speculative purposes. Refer to Note 17, *Derivative Instruments and Hedging Activities*, in the Notes to the Consolidated Financial Statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2004.

Management's Discussion & Analysis of Financial Condition & Results of Operations (continued)

Disclosures for Derivative Financial Instruments

Notional amounts *(dollars in millions)*	**Receive Fixed**	**Amortizing Floating for Floating**	**Interest Rate Caps**	**Other Derivative Products**	**Total**
Balance at December 31, 2003	$ 540	$ 626	$ 1,833	$ 54	$ 3,053
Additions	915	—	—	—	915
Maturities/amortizations	(75)	(126)	(27)	(54)	(282)
Terminations	(25)	—	—	—	(25)
Balance at December 31, 2004	$ 1,355	$ 500	$ 1,806	$ —	$ 3,661

Various uses of derivative instruments at December 31, 2004

(dollars in millions)	
Interest rate swaps utilized to create synthetic floating-rate debt to achieve a lower cost of funding	$ 1,355
Asset/liability management purposes	1,999
Other purposes	307
Total interest rate swaps and caps outstanding	$ 3,661

Employee Retirement Plans

As of December 31, 2004, AgFirst had contributed $18,904 to the Districtwide defined benefit retirement plan. The Districtwide funding in 2004 brought the retirement plan's assets to an amount that exceeded the Accumulated Benefit Obligation as of the Plan's measurement date, eliminating the minimum pension liability and the charge to accumulated other comprehensive income. See Note 11, *Employee Benefit Plans*, in the Notes to the Consolidated Financial Statements of this report for further information.

Preferred Stock

On May 17, 2001, AgFirst issued $225,000 of Class A Mandatorily Redeemable Cumulative Preferred Stock, Series 1, at a par value of $1 thousand per share. This stock is mandatorily redeemable on December 15, 2016 and carries a stated annual dividend rate of (1) 8.393 percent until December 15, 2011, with dividends paid semi-annually on June 15th and December 15th and (2) thereafter at a floating rate per annum equal to 3 month LIBOR plus 3.615 percent with dividends payable quarterly commencing March 15, 2012. On or after the dividend payment date in December, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of $1 thousand per share.

On October 14, 2003, AgFirst issued $150,000 of Class A Perpetual Non-Cumulative Preferred Stock, Series 2 at a par value of $1 thousand per share. Dividends on the stock are non-cumulative and payable on the 15th day of June and December in each year, commencing December 15, 2003, at an annual rate equal to 7.30 percent. In the event dividends are not declared on the preferred stock for payment on any dividend payment date, then such dividends shall not accumulate and shall cease to accrue and be payable. On and after the dividend payment date in December 2008, the Bank may, at its option, redeem the preferred stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for then current dividend period to the date of redemption.

See Note 9, *Mandatorily Redeemable Preferred Stock*, and Note 10, *Shareholders' Equity*, of the Notes to the Consolidated Financial Statements of this annual report for more detailed information concerning the preferred stock issuances.

Capital

Total shareholders' equity at December 31, 2004 was $1,024,296 compared to $954,532 and $756,845 at December 31, 2003 and 2002, respectively. The increasing trend in shareholders' equity is attributed to the issuance of perpetual preferred stock in 2003 and increases in retained earnings, offset somewhat by a decrease in outstanding capital stock resulting from the redemption by AgFirst of a portion of its capital stock. In addition, reductions in the charges to the accumulated other comprehensive income were offset by increased patronage distributions in 2004 compared to 2003.

Capital adequacy is evaluated using a number of regulatory ratios. For all periods presented, AgFirst exceeded minimum regulatory standards for all of these ratios. Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104 percent compared to the regulatory minimum of 103 percent. At December 31, AgFirst's regulatory ratios were:

	Regulatory	**AgFirst Ratio as of**		
	Minimum	**12/31/04**	**12/31/03**	**12/31/02**
Permanent Capital Ratio	7.00%	26.86%	25.99%	22.91%
Total Surplus Ratio	7.00%	26.76%	25.79%	22.69%
Core Surplus Ratio	3.50%	15.60%	14.45%	13.20%
Collateral Ratio	103.00%	106.88%	106.94%	105.94%

The significant improvement in the permanent capital, total surplus and net collateral ratios from December 31, 2002 to December 31, 2004 was primarily due to the issuance of $150 million of perpetual preferred stock. The stock had no impact on the core surplus ratio.

Additionally, the permanent capital, total surplus, and core surplus ratios from December 31, 2002 to December 31, 2003 were enhanced by the accumulation of earnings, offset somewhat by asset growth.

Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-weighting of assets. The growth in the direct note and investment portfolios generally carry a 20 percent risk weighting in the three capital ratios, offset the accumulation of earnings, resulting in the stable collateral ratio from 2003 to 2004.

Refer to Note 10, *Shareholders' Equity*, in the Notes to the Consolidated Financial Statements for additional information.

The Districtwide Young, Beginning, and Small Farmers and Ranchers (YBS) Program

AgFirst and the Associations, recognizing that YBS farmers are vitally important to the future of agriculture, are committed to continue offering programs to help educate, assist, and provide quality financial services to YBS farmers. The Associations have sponsored and supported the majority of the YBS Farmer programs throughout the District. In addition, AgFirst has sponsored YBS initiatives jointly with the Associations as well as supported individual state and national programs. The 2004 YBS program that AgFirst sponsored included numerous state Cooperative Councils. Management will continue to consider sponsorship of future, district-wide YBS Farmer activities as opportunities arise.

YBS farmers and ranchers are defined as:

Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.

Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date the loan is originally made.

Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $250 (thousand) in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

All District Associations offer some types of credit and related services to YBS borrowers with 100 percent of the Associations offering services with the Farm Service Agency. Many also coordinate with state programs, dealers/merchants, and other farm groups.

The following table reflect the December 31, 2004 business activity with young, beginning, and small farmers, ranchers, and producers or harvesters of aquatic products:

AgFirst Farm Credit District
Young, Beginning and Small Farmers and Ranchers
Number/Volume of Loans Outstanding
December 31, 2004

Category	Number of Loans	Volume Outstanding
Total loans and commitments outstanding	131,178	$17,233,839
Young farmers and ranchers	20,480	1,639,955
Beginning farmers and ranchers	31,426	3,158,888
Small farmers and ranches	89,559	5,994,778

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

Legal Proceedings

On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from legal actions pending against the Bank would be immaterial in relation to the financial position of the Bank. Refer to Note 15, C*ommitments and Contingencies*, in the Notes to the Consolidated Financial Statements for additional information.

Recent Regulatory Matters

On February 24, 2004, the FCA published a final notice in the Federal Register that loan syndication transactions by System institutions to eligible borrowers must be treated as direct loans meeting all statutory and regulatory requirements, rather than as loan participations. In addition, FCA indicated that since Farm Credit Banks can no longer make direct loans to eligible borrowers, they cannot directly take part in loan syndication transactions to eligible borrowers. Syndication transactions with certain entities whose operations are functionally similar to those of an eligible borrower (similar entity) are not impacted by the final notice. FCA has included certain transitional provisions with respect to existing loan syndications to eligible borrowers.

Our future loan syndication transactions under the direct lending authorities will be required to address borrower rights, territorial concurrency, and stock requirements. To date, we have been able to minimize the impact of FCA's ruling on syndications through the cooperation of commercial lenders and System institutions not subject to all aspects of the ruling.

Additional Disclosures 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 to 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 to shareholders.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Columbia, South Carolina:

Location	Description
1401 Hampton Street	Bank building and adjacent parking
1441 Hampton Street	Vacant
1443 Hampton Street	AgFirst Federal Credit Union
1447 Hampton Street	Vacant
1428 Taylor Street	AgFirst training center
1436 Taylor Street	Leased

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 15 to the consolidated financial statements, *Commitments and Contingencies*, included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 10 to the consolidated financial statements, *Shareholders' Equity*, included in this annual report to shareholders.

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, 7, 8, 12 and 15 to the consolidated financial statements included in this annual report to shareholders.

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 to shareholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the directors and senior officers of the reporting entity.

The business experience for the past five years for senior officers is with the Farm Credit System.

Senior Officer	Position
F. A. (Andy) Lowrey	President and Chief Executive Officer
Thomas S. Welsh	Executive Vice President, Chief Administrative and Legislative Officer & Corporate Secretary
William R. Clayton	Senior Vice President, Lending & Operations Officer
Leon T. Amerson	Senior Vice President & Chief Financial Officer
Benjamin F. Blakewood	Senior Vice President, Chief Information Officer

The total amount of compensation earned by the CEO and the highest paid officers as a group (including the CEO) during the years ended December 31, 2004, 2003 and 2002, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2004	$ 415,286	$116,280	$ 29,070	$ 15,120	$ 575,756
F. A. Lowrey	2003	$ 377,534	$105,710	$ 26,427	$ 15,045	$ 524,716
F. A. Lowrey	2002	$ 343,213	$102,964	$ —	$ 15,056	$ 461,233
5 Officers	2004	$1,183,639	$190,409	$ 99,122	$ 64,389	$ 1,537,559
5 Officers	2003	$1,075,450	$209,571	$ 73,444	$ 62,112	$ 1,420,577
5 Officers	2002	$1,087,203	$289,658	$ —	$ 64,589	$ 1,441,450

* *Primarily comprised of company contributions to thrift plan, group life insurance premiums and automobile compensation.*

In addition to a base salary, senior officers earn additional compensation under the Bank's Corporate Bonus Plan. The plan is designed to motivate employees to exceed specific performance targets related to return on equity (ROE) and other financial measures, and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2004 bonus was made in the first quarter of 2005.

Disclosure of the total compensation in 2004 to any senior officer, or to any other individual included in the total whose compensation exceeds $50,000, is available to shareholders upon request.

AgFirst Farm Credit Bank Board of Directors

Name	Position	Term of Office
E. McDonald Berryman	Chairman	December 31, 2005
Robert G. Sexton	Vice Chairman	December 31, 2007
William C. Bess, Jr.	Director	December 31, 2005
Dr. Chester D. Black	Director	December 31, 2006
Robert A. Carson	Director	December 31, 2006
R. Tommy Clay, Sr.	Director	December 31, 2004
Henry M. Frazee	Director	December 31, 2008**
Don W. Freeman	Director	December 31, 2005
Robert L. Holden, Sr.	Director	December 31, 2006
Paul M. House	Director	December 31, 2007
Thomas W. Kelly	Director	December 31, 2004*
Lyle Ray King	Director	December 31, 2008**
Richard Kriebel	Director	December 31, 2007
M. Wayne Lambertson	Director	December 31, 2005
Paul Lemoine	Director	December 31, 2007
F. Merrel Lust	Director	December 31, 2005
Eugene W. Merritt, Jr.	Director	December 31, 2006
Dale W. Player	Director	December 31, 2007
J. Dan Raines, Jr.	Director	December 31, 2005
Walter L. Schmidlen, Jr.	Director	December 31, 2004*
Robert E. Strayhorn	Director	December 31, 2004

* *These directors have been re-elected to new 4-year term ending 12/31/08.*
** *These directors were newly elected to 4-year terms commencing 1/1/05 to replace Directors Clay and Strayhorn, who did not seek re-election.*

E. McDonald Berryman, Chairman of the Board, is a farmer from Elberon, Virginia and is president of Beechland Farms, Inc., a family-owned and operated farm in Surry County, Virginia. His operations consist of 4,000 acres of row crops including peanuts, corn, wheat, soybeans and cotton, and also 1,000 acres of growing timber. He served as past president of Peanut Farmers LLC and is a member of the Surry County Farm Bureau.

Robert G. Sexton, Vice Chairman of the Board, is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association and co-owner of Orchid Island Juice Company. He serves as a director of Farm Credit of South Florida, ACA, Florida Citrus Packers, Indian River Citrus League, Highland Exchange Service Co-op and McArthur Management Company. In addition, he is a member of the Indian River Farm Bureau.

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders Supply Co. and has brood cow operations. He serves on the national Farm Credit Council Board, and is a member of the Cleveland County and Catawba Cattlemen's Associations.

Dr. Chester D. Black of Raleigh, North Carolina, serves as the board's outside director. Dr. Black previously served as director of the North Carolina Agriculture Extension Service at North Carolina State University.

Robert A. Carson, a row crop farmer in the Mississippi Delta, is active in a number of agricultural organizations. He is a director of the Delta Council and a member of the national Farm Credit Council Board.

R. Tommy Clay, Sr. operates a cattle ranch in Putnam County, Florida, and is also involved in real estate development. For more than three decades he has served as a director of the Putnam County Fair and the Rodeheaver Boys Ranch.

Henry M. (Buddy) Frazee of Alachua, Florida, is a managing partner of the BJ Bar Ranch, headquartered in Gainesville, Florida. The ranch's operations include 1,000 brood cows, 8,000 acres of planted timber and a 2,000-acre game management farm. He currently serves on the board of Farm Credit of North Florida. Mr. Frazee was newly elected to the board with his term beginning January 1, 2005.

Don W. Freeman is a farmer-rancher from Montgomery, Alabama. He is a member of Lowndes County Alabama Farmers Federation and Cattlemen's Association, and is past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers.

Robert L. Holden, Sr. is co-owner and operator of a dairy, a 900-acre row-crop farm, and a 200,000 broiler operation in Whigham, Georgia. He is a director of the Southwest Georgia Farm Credit, ACA, Georgia Milk Producers, and Grady County Farm Bureau.

Paul M. House is from Nokesville, Virginia, where he grows corn, soybeans, wheat, hay and turf grass. He also operates a dairy. He serves as a director of the Farm Credit of the Virginias, ACA.

Thomas W. Kelly, from Tyrone, Pennsylvania, is owner-operator of a dairy and crop farm. The dairy herd consists of registered Holsteins whose genetics are merchandized. Major crops include corn, alfalfa, soybeans and seed barley. He currently serves on the board of AgChoice Farm Credit, ACA.

Lyle Ray King of Ash, North Carolina, owns and operates a 2,500-acre farm where he grows, tobacco, corn, soybeans and wheat. He currently serves on the boards of Cape Fear Farm Credit, Atlantic Telephone Membership Cooperative, and Landbank Resource Management, a real estate company. Mr. King was newly elected to the board with his term beginning January 1, 2005.

Richard Kriebel is a contract farmer from Benton, Pennsylvania, raising contract forage and grain. His crops consist of owned-and-leased acres of corn and hay. He is a director of AgChoice Farm Credit, ACA, and a former member of the Columbia County ASCS, Columbia County Extension and the Columbia County Planning Commission.

M. Wayne Lambertson of Pokomoke City, Maryland, owns and operates a 2,700-acre farm of corn, soybeans, and wheat, and a 300,000 capacity broiler operation. He currently serves on the MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization. He also serves on the board of the national Farm Credit Council.

Paul Lemoine is a cattle and row crop farmer from Plaucheville, Louisiana. He is active in a number of organizations related to farming, and is employed as a crop sales consultant with Agriliance Chemical Co. He is a member of the Louisiana Cattlemen's Association and the Avoyelles Parish Farm Bureau.

Additional Disclosures Required by Farm Credit Administration Regulations (continued)

F. Merrel Lust is from Marion, Ohio, and grows corn, soybeans, and wheat on a 5,900-acre operation in partnership with his twin brother, son and nephew. He currently serves as a member of the board of Ag Credit ACA.

Eugene W. Merritt, Jr., from Easley, South Carolina, is co-owner of an ornamental tree farm and is a landscape contractor. He also operates a 400-acre timber and grass farm. He serves on the board of AgSouth Farm Credit, ACA.

Dale W. Player is co-owner of a 1,850-acre row crop operation, with cotton being the primary crop. He is a director of Pee Dee Farm Credit, ACA, member of the South Carolina Cotton Board of Directors, and director of the Carolinas Cotton Cooperative.

J. Dan Raines, Jr. is a farmer from Ashburn, Georgia. His farming operations include beef cattle, registered Angus cattle and timber. He serves as a director on the board of AgGeorgia Farm Credit, ACA and the Federal Agricultural Mortgage Corporation (Farmer Mac). He also serves on the board for Raines Commercial Gruop, Inc., which is primarily engaged in employee leasing.

Walter L. Schmidlen, Jr., from Elkins, West Virginia, is a dairy and beef farmer. He is owner and operator of a farm machinery business and grows hay and corn on a 700-acre farm. He presently serves on the board of the Farm Credit of the Virginias, ACA, and was a former director of Southern States Cooperative and Sire Power.

Robert E. Strayhorn is a farmer from Chapel Hill, North Carolina. His farming operations include brood cows, feeder calves, timber and row crops. He serves as a director on the board of Carolina Farm Credit, ACA, chairman of the Seven County Junior Livestock Show and Sale Committee, and is active in the Orange County Farm Bureau.

Compensation of Directors

Directors are compensated in cash at the rate of $26,358 per year, the maximum allowed by FCA regulations. This is compensation for attendance at board meetings, certain other meetings pre-approved by the board, and other duties as assigned. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. Amounts paid in excess of $26,358 to board officers and board members represented service for Farm Credit Council (FCC) activities, including FCC board meetings, other FCC board activities, congressional visitations, greater than normal involvement in customer meetings, and additional time and responsibilities for audit and other board committee functions. Total cash compensation paid to all directors as a group during 2004 was $592,002. Additional information for each director who served during 2004 is provided below.

	Number of Days Served			
Name of Director	Board Meetings	Farm Credit Council Board Activities	Other Official Activities**	Total Comp. Paid During 2004
E. McDonald Berryman	26	9.5	14.25	$ 31,158
William C. Bess, Jr.	26	9.5	15.50	31,158
Dr. Chester D. Black	23	9.5	12.25	31,158
Robert A. Carson	26	9.5	12.50	31,158
R. Tommy Clay, Sr.	25	9.5	5.25	31,158
Don W. Freeman	26	9.5	10.50	31,158
Robert L. Holden, Sr.	23	9.5	12.00	31,158
Paul M. House	26	9.5	16.50	31,158
Thomas W. Kelly	26	9.5	19.50	31,158
Richard Kriebel	26	9.5	11.25	31,158
M. Wayne Lambertson	26	9.5	15.25	31,158
Paul Lemoine	26	9.5	16.50	31,158
F. Merrel Lust	25	6.0*	10.50	31,158
Eugene W. Merritt, Jr.	26	9.5	13.25	31,158
Dale W. Player	26	9.5	27.25	31,158
J. Dan Raines, Jr.	26	9.5	18.50	31,158
Walter L. Schmidlen, Jr.	26	9.5	13.50	31,158
Robert G. Sexton	25	9.5	6.50	31,158
Robert E. Strayhorn	23	9.5	11.00	31,158
Total				$ 592,002

* Weather interrupted travel to meeting.
** Includes board committee meetings.

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 13 to the consolidated financial statements, *Related Party Transactions*, included in this annual report to shareholders.

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.

Relationship with Independent Public Accountants

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

Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 4, 2005, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

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 Jay Wise, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. These reports can also be viewed or obtained by going to the Bank's website at ***www.agfirst.com***.

Report of the Audit Committee

The Audit Committee of the Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Audit Committee is an employee of AgFirst Farm Credit Bank (the Bank) and in the opinion of the Board of Directors, each is free of any relationship with the Bank 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 Bank's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Bank's independent auditor for 2004, is responsible for expressing an opinion on the conformity of the Bank's audited financial statements with generally accepted accounting principles. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 *(Communication With Audit Committees)*. 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 Bank is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Bank's Annual Report for 2004 and that PwC be appointed independent auditor for the Bank for 2005. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:

J. Dan Raines, Jr.
Chairman of the Audit Committee

Members of Audit Committee
Dr. Chester D. Black
Robert A. Carson
Henry M. Frazee
Paul M. House
Walter L. Schmidlen

March 4, 2005

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

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

Report of Independent Auditors

March 4, 2005

To the Board of Directors and Shareholders
of AgFirst Farm Credit Bank

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank and its subsidiary at December 31, 2004, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Bank'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.

As discussed in Note 2, the Bank changed its method of accounting for its mandatorily redeemable preferred stock effective July 1, 2003.

PricewaterhouseCoopers LLP

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2004	December 31, 2003	December 31, 2002
Assets			
Cash and cash equivalents	$ 470,258	$ 469,945	$ 359,819
Investment securities, available for sale	3,278,414	2,832,716	2,153,118
Loans	12,908,249	12,375,351	12,008,041
Less: allowance for loan losses	14,800	34,168	31,155
Net loans	12,893,449	12,341,183	11,976,886
Accrued interest receivable	50,630	44,978	50,470
Investments in other Farm Credit System institutions	66,646	78,672	78,251
Premises and equipment, net	27,920	24,995	18,722
Due from associations	30,385	39,839	24,512
Other assets	69,821	47,220	39,412
Total assets	$ 16,887,523	$ 15,879,548	$ 14,701,190
Liabilities			
Bonds and notes	$ 15,402,385	$ 14,507,105	$ 13,538,536
Mandatorily redeemable preferred stock (Note 9)	225,000	225,000	—
Accrued interest and dividends payable	65,854	52,024	43,732
Patronage distribution payable	126,689	92,129	85,477
Postretirement benefits other than pensions	13,943	11,688	10,512
Minimum pension liability	—	8,751	10,449
Other liabilities	29,356	28,319	29,800
Total liabilities	15,863,227	14,925,016	13,718,506
Commitments and contingencies (Note 15)			
Mandatorily redeemable preferred stock (Note 9)	—	—	225,839
Shareholders' Equity			
Perpetual preferred stock (Note 10)	150,000	150,000	—
Capital stock and participation certificates	226,200	229,083	249,444
Retained earnings	644,366	601,699	527,673
Accumulated other comprehensive income (loss)	3,730	(26,250)	(20,272)
Total shareholders' equity	1,024,296	954,532	756,845
Total liabilities and shareholders' equity	$ 16,887,523	$ 15,879,548	$ 14,701,190

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

Consolidated Statements of Income

	For the year ended December 31,		
(dollars in thousands)	**2004**	**2003**	**2002**
Interest Income			
Investment securities and other	$ 74,565	$ 59,401	$ 62,836
Loans	469,774	469,148	544,575
Total interest income	544,339	528,549	607,411
Interest Expense	332,744	284,492	351,751
Net interest income	211,595	244,057	255,660
Provision for (reversal of) loan losses	(15,292)	2,500	8,000
Net interest income after provision for loan losses	226,887	241,557	247,660
Noninterest Income			
Loan fees	11,751	14,140	11,548
Realized gains (losses) on investments, net	3,345	247	(1,388)
Secondary mortgage operations income (loss)	(927)	(6,729)	13,992
Other noninterest income	3,852	1,855	119
Total noninterest income	18,021	9,513	24,271
Noninterest Expenses			
Salaries and employee benefits	26,172	23,367	22,507
Occupancy and equipment	9,823	8,552	7,966
Insurance fund premium	845	2,014	632
Other operating expenses	15,448	13,088	15,985
Intra-System financial assistance expenses	6,794	13,308	15,458
Called debt expense	3,360	11,736	13,518
Other noninterest expenses	2,160	1,556	1,732
Total noninterest expenses	64,602	73,621	77,798
Net income	$ 180,306	$ 177,449	$ 194,133

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

Consolidated Statements of Changes in Shareholders' Equity

(dollars in thousands)	Perpetual Preferred Stock	Capital Stock and Participation Certificates	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2001	$ —	$ 281,803	$ 439,104	$ 7,041	$ 727,948
Comprehensive income					
Net income			194,133		194,133
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $(1,388)				6,856	6,856
Change in fair value of derivative instruments				(16,782)	(16,782)
Minimum pension liability adjustment				(17,387)	(17,387)
Total comprehensive income					166,820
Capital stock/participation certificates issued/retired, net		(32,359)			(32,359)
Mandatorily redeemable preferred stock dividends accrued			(18,887)		(18,887)
Cash distributions			(86,677)		(86,677)
Balance at December 31, 2002	—	249,444	527,673	(20,272)	756,845
Comprehensive income					
Net income			177,449		177,449
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $247				(9,480)	(9,480)
Change in fair value of derivative instruments				2,116	2,116
Minimum pension liability adjustment				1,386	1,386
Total comprehensive income					171,471
Perpetual preferred stock issued	150,000				150,000
Capital stock/participation certificates issued/retired, net		(20,361)			(20,361)
Perpetual preferred stock dividends paid			(1,851)		(1,851)
Mandatorily redeemable preferred stock dividends accrued			(9,443)		(9,443)
Cash distributions			(92,129)		(92,129)
Balance at December 31, 2003	150,000	229,083	601,699	(26,250)	954,532
Comprehensive income					
Net income			180,306		180,306
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $3,345				1,859	1,859
Change in fair value of derivative instruments				12,120	12,120
Minimum pension liability adjustment				16,001	16,001
Total comprehensive income					210,286
Capital stock/participation certificates issued/retired, net		(2,883)			(2,883)
Perpetual preferred stock dividends paid			(10,950)		(10,950)
Cash distributions			(126,689)		(126,689)
Balance at December 31, 2004	$ 150,000	$ 226,200	$ 644,366	$ 3,730	$ 1,024,296

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Cash flows from operating activities:			
Net income	$ 180,306	$ 177,449	$ 194,133
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	6,016	4,955	4,130
Provision for (reversal of) loan losses	(15,292)	2,500	8,000
Realized (gains) losses on investments, net	(3,345)	(247)	1,388
Realized (gains) losses on mortgage loans held for sale	2,446	1,859	(14,301)
Proceeds from sale of mortgage loans held for sale	255,951	754,486	806,473
Purchases of mortgage loans held for sale (net of principal repayment)	(327,808)	(667,196)	(531,977)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(5,652)	5,492	6,301
(Increase) decrease in investments in other Farm Credit System institutions	12,026	(421)	(486)
(Increase) decrease in other assets	495	(23,135)	(13,648)
Increase (decrease) in accrued interest and dividend payable	13,830	8,292	(16,710)
Increase (decrease) in postretirement benefits other than pensions	2,255	1,176	910
Increase (decrease) in minimum pension liability	(8,751)	(1,698)	10,449
Increase (decrease) in other liabilities	(7,053)	(95)	(13,666)
Total adjustments	(74,882)	85,968	246,863
Net cash provided by operating activities	105,424	263,417	440,996
Cash flows from investing activities:			
Investment securities purchased	(4,091,449)	(4,826,206)	(3,040,275)
Investment securities sold or matured	3,650,955	4,137,375	2,555,948
Net (increase) decrease in loans	(467,219)	(454,746)	(1,143,087)
Purchase of premises and equipment, net	(8,941)	(11,228)	(6,030)
Net cash used in investing activities	(916,654)	(1,154,805)	(1,633,444)
Cash flows from financing activities:			
Bonds and notes issued	41,613,253	57,612,055	49,737,367
Bonds and notes retired	(40,695,748)	(56,641,370)	(48,331,322)
Perpetual preferred stock issued	—	150,000	—
Capital stock and participation certificates issued/retired, net	(2,883)	(20,361)	(32,359)
Cash distributions to shareholders	(92,129)	(86,677)	(67,786)
Dividends paid on perpetual preferred stock	(10,950)	(1,851)	—
Dividends paid on mandatorily redeemable preferred stock	—	(10,282)	(18,887)
Net cash provided by financing activities	811,543	1,001,514	1,287,013
Net increase in cash and cash equivalents	313	110,126	94,565
Cash and cash equivalents, beginning of period	469,945	359,819	265,254
Cash and cash equivalents, end of period	$ 470,258	$ 469,945	$ 359,819
Supplemental schedule of non-cash investing and financing activities:			
Change in unrealized gains (losses) on investments	$ 1,859	$ (9,480)	$ 6,856
Change in fair value of derivative instruments	12,120	2,116	(16,782)
Change in pension liability related to other comprehensive income	16,001	1,386	(17,387)
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ (344)	$ (1,894)	$ (1,024)
Increase (decrease) in bonds and notes	(22,225)	1,082	(8,478)
Decrease (increase) in other assets	2,359	(1,564)	9,328
Increase (decrease) in other liabilities	8,090	(3,107)	561
Supplemental information:			
Interest paid	$ 318,914	$ 276,200	$ 368,461

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** AgFirst Farm Credit Bank (the Bank or AgFirst) is one of the banks of the Farm Credit System (the System), a nationwide system of cooperatively owned banks (the banks) and associations, established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act).

The nation is currently served by four Farm Credit Banks (FCBs), each of which has specific lending authorities within its chartered territory, and one Agricultural Credit Bank (ACB), which has nationwide lending authorities. The ACB also has lending authorities of an FCB within its chartered territories. The Bank is chartered to service the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, the Commonwealth of Puerto Rico and portions of the states of Ohio, Tennessee, Kentucky and Louisiana.

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as Associations. AgFirst and its related associations (District Associations or Associations) are collectively referred to as the District. The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2004, the District consisted of the Bank and twenty-three District ACAs. Twenty-one have restructured as holding companies, which includes twenty-one FLCA and PCA subsidiaries. Effective January 1, 2005, the remaining two District Associations also restructured as holding companies with FLCA and PCA subsidiaries.

Each FCB and the ACB is responsible for supervising the activities of the Associations within its district. The FCBs and/or Associations make loans to or for the benefit of eligible borrowers/shareholders for qualified purposes. Funds for the FCBs and the ACB are raised principally through the sale of consolidated Systemwide bonds and notes to the public.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the Bank and Associations. The activities of the Bank and Associations are examined by the FCA and certain actions by these entities are subject to the FCA's prior approval.

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 the discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund based on its annual average District loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations). 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 Bank.

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' loan portfolios. These lines of credit are collateralized by a pledge of substantially all of each Association's assets. The terms of the revolving lines of credit are governed by a general financing agreement between the Bank and each Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized. Advances are also made to fund general operating expenses of the Associations.

The Associations borrow from the Bank and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members.

In addition to providing loan funds to District Associations, the Bank provides to the District Associations banking and support services such as accounting, human resources, information systems, and marketing. The costs of these support services are included in the interest charges to the Associations.

The Bank is also authorized to provide, in participation with other lenders and the secondary market, 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 Bank may also lend to other financial institutions qualified to engage in lending to eligible borrowers.

The Bank owns the Farm Credit Finance Corporation of Puerto Rico (the Finance Corporation). The Finance Corporation currently borrows funds from the Bank and eligible funds from qualified companies doing business in Puerto Rico under Section 2(j) of the Puerto Rico Tax Incentive Act of 1987, as amended, or the Puerto Rico Tax Incentive Act of 1998, including corporations that have elections under Section 936 and 30(A) of the Internal Revenue Code of 1986, as amended (Code), and may borrow funds from other sources within or outside Puerto Rico in the future. The funds so borrowed are primarily used to acquire from AgFirst the note receivable from Puerto Rico Farm Credit, ACA, and to acquire eligible loans originated by other System institutions. Savings in interest costs are, in part, passed along to borrowers in Puerto Rico who meet certain eligibility requirements.

The Bank, in conjunction with other System banks, jointly owns service organizations, which were created to provide a variety of services for the System:

- *Federal Farm Credit Banks Funding Corporation (Funding Corporation)* — provides for the issuance, marketing and processing of Systemwide Debt Securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.
- *FCS Building Association* — leases premises and equipment to the FCA.
- *Farm Credit System Association Captive Insurance Company* — being a reciprocal insurer, provides insurance services to its member organizations.

Notes to the Consolidated Financial Statements (continued)

These investments are accounted for using the cost method. In addition, the *Farm Credit Council* acts as a full-service federated trade association, which represents the System before Congress, the Executive Branch and others, and provides support services to System institutions on a fee basis.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Bank conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires the management of the Bank 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 can differ from these estimates. Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

The accompanying consolidated financial statements include the accounts of the Bank (including the Finance Corporation), and reflect the investments in and allocated earnings of the service organizations in which the Bank has partial ownership interests. All significant transactions and balances between the Bank and the Finance Corporation have been eliminated.

A. **Cash and Cash Equivalents:** Cash and Cash Equivalents include cash on hand and short-term investments with original maturities of three months or less.

B. **Investment Securities**: The Bank, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Bank's investments may not necessarily be held to maturity and accordingly have been classified as available for sale and reported at fair value. The fair values of the related hedges are reported in other assets or other liabilities in the Consolidated Balance Sheet. Changes in the fair value of investments classified as available for sale and of the related hedges are reflected as direct charges or credits to shareholders' equity. Realized gains and losses are determined using the specific identification method and are recognized in current operations.

The Bank reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or permanent. In the event of permanent impairment, the cost basis of the investment would be written down to its fair value, and the realized loss would be included in current earnings.

C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have maturities ranging up to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans are carried at their principal amount outstanding less unearned income adjusted for SFAS No. 133 valuation adjustments. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (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 reversed (if accrued in the current year) and/or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, the interest portion of payments received in cash is generally 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 asset. Nonaccrual loans may be transferred 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."

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses in the loan portfolio. 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 allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses 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 determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans under SFAS 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. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

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

- Credit risk classifications,
- Collateral values,
- Risk concentrations,
- Weather related conditions, and
- Economic conditions.

D. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.

E. **Other Assets and Liabilities:** Direct expenses incurred in issuing debt and preferred stock are deferred and amortized using the straight-line method (which approximates the interest method) over the term of the related indebtedness and term of the preferred stock.

Derivative financial instruments are included in the consolidated balance sheet, at fair value, as either other assets or other liabilities.

F. **Employee Benefit Plans:** Bank employees participate in a districtwide defined benefit retirement plan (the Plan) within the District. The "Projected Unit Credit" actuarial method is used for financial reporting purposes and funding purposes. Based on the funded status at the Plan's measurement date (September 30), the Bank may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). 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. 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.

Bank employees are eligible to participate in the thrift/deferred compensation plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Bank contributes $.50 for each $1.00 of the employee's first 6 percent of contribution up to the maximum employer contribution of 3 percent of total compensation. For employees hired after January 1, 2003, the Bank contributes $1.00 for each $1.00 of the employee's first 6 percent of contribution up to the maximum employer contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

In addition to providing pension benefits, the Bank provides certain health care and life insurance benefits for retired employees (other postretirement benefits). Substantially all of the Bank's employees are eligible for those benefits when they reach early retirement age while working for the Bank. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002 are required to pay the full cost of their retiree health insurance coverage.

The Bank also sponsors supplemental retirement and deferred compensation plans for highly compensated employees. The plans are nonqualified; therefore, the associated liabilities are included in the Bank's consolidated balance sheets in other liabilities.

G. **Income Taxes:** The Bank is exempt from Federal and other income taxes as provided in the Farm Credit Act. The Finance Corporation is eligible to receive a partial credit for taxes payable on Puerto Rico sourced income in accordance with Section 936 of the Internal Revenue Code of 1986, as amended. See Note 1(B) — *Operations*.

H. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps and caps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. Derivatives are included in the consolidated balance sheet as assets and liabilities and reflected at fair value.

Changes in the fair value of a derivative are recorded in current period earnings or accumulated other comprehensive income (loss) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions which hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative will generally be deferred and reported in accumulated other comprehensive income (loss). The gains and losses on the derivative that are deferred and reported in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) specific assets or liabilities on the balance sheet or (2) firm commitments or forecasted transactions. The Bank also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. The Bank uses regression analysis (or other statistical analysis) to assess the effectiveness of its hedges. The Bank discontinues hedge accounting prospectively when the Bank determines that a hedge has not been or is not expected to be effective as a hedge. For cash flow hedges, any remaining accumulated other comprehensive income (loss) would be amortized into earnings over the remaining life of the original hedged item. For fair value hedges, changes in the fair value of the derivative will be recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

The Bank may occasionally purchase a financial instrument in which a derivative instrument is "embedded." Upon purchasing the financial instrument, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value and designated as either a fair value or cash flow hedge. However, if the entire contract were to be measured at fair value, with changes in fair value reported in current earnings, or if the Bank could not reliably identify and measure the embedded derivative for purposes of separating that derivative from its host contract, the entire contract would be carried on the balance sheet at fair value and not be designated as a hedging instrument.

I. **Valuation Methodologies:** Management of the Bank applies various 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, such as most investment securities. However, for those items for which an observable liquid market does not exist, management utilizes significant estimates and assumptions to value those items. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain derivative and 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 Bank's results of operations.

J. **Recent Accounting Developments:**

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 applies specifically to a number of financial instruments that companies have historically presented within their financial

Notes to the Consolidated Financial Statements (continued)

statements either as equity or between the liabilities section and the equity section, rather than as liabilities. On November 7, 2003, the FASB issued FASB Staff Position (FSP) 150-3, *Effective Date and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities*. FSP 150-3 defers the effective date of certain provisions of SFAS No. 150, specifically the provisions that apply to mandatorily redeemable noncontrolling interests. This deferral is expected to remain in effect indefinitely until the accounting for these interests is addressed in later guidance. The remaining provisions of SFAS No. 150 were effective for financial instruments entered into or modified after May 31, 2003, and otherwise were effective and adopted by the Bank on July 1, 2003. As a result of adoption, effective July 1, 2003, the Bank's mandatorily redeemable preferred stock of $225 million was reclassified to liabilities and the related dividends paid on that stock are treated as interest expense beginning July 1, 2003, rather than as a direct reduction of unallocated surplus. See Note 9 for further discussion.

In December 2003, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position (SOP) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. The SOP is effective for loans acquired in fiscal years beginning after December 15, 2004. The SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans acquired in business combinations. The SOP does not apply to loans originated by the Bank. The Bank adopted the provisions of SOP 03-3 effective January 1, 2005, and the initial implementation did not have a significant effect on the Bank's consolidated financial position or consolidated results of operations.

In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernation Act of 2003* (the Act). This Staff Position provides guidance on the accounting for the effects of the Act for employees that sponsor postretirement health care plans that provide prescription drug benefits. The disclosures required by FSP 106-2 are included in Note 11, *Employee Benefit Plans*.

In May 2004, the Emerging Issues Task Force (EITF) released EITF Issue 03-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. The Issue provided guidance for evaluating whether an investment is other-than-temporarily impaired and requires certain disclosures with respect to these investments. In September 2004, the FASB issued FSP EITF Issue 03-1-1, *Effective Date of Paragraph 10-20 of EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. This Staff Position delayed certain measurement and recognition provisions of EITF 03-1. On December 31, 2004, the Bank held certain investments having continuous unrealized loss positions for more than 12 months with a fair value totaling $98.1 million and an unrealized loss position totaling $341 thousand. Substantially all of these investments were in U. S. Government securities and we expect that these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by interest rate increases and not credit quality, and because the Bank has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Bank has not recognized any other-than-temporary impairment in connection with these investments.

In December 2004, The FASB issued SFAS No. 153, *Exchange of Nonmonetary Assets – an amendment of APB Opinion No. 29*. The statement requires that exchanges of nonmonetary assets be accounted for at fair value unless the exchange lacks commercial substance. A nonmonetary exchange has commercial substance when the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement eliminates a provision in APB Opinion No. 29, which exempted nonmonetary exchanges of similar productive assets from fair value accounting. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in periods beginning after June 15, 2005. Management currently does not anticipate that the effects of the statement will materially affect the Bank's consolidated financial position or consolidated results of operations.

Note 3 – Refinement of the Allowance for Loan Losses Methodology

During 2004, the Bank conducted a study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

The Bank's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account credit losses in that period. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Bank's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Bank's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

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

During the fourth quarter of 2004, the Bank completed its study and refined the methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the $15.3 million reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Bank, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $1,039 million at December 31, 2004 (8.05 percent of Bank loans), as compared with $989 million at December 31, 2003 (7.99 percent of Bank loans), and $788 million at December 31, 2002 (6.56 percent of Bank loans).

Note 4 — Investment Securities

A summary of the amortized cost and fair value of debt securities held as investments at December 31, 2004, 2003 and 2002, follows:

December 31, 2004	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 29,957	$ —	$ —	$ 29,957	2.35%
U.S. Govt. GNMA MBS/CMOs	1,079,707	3,047	(1,911)	1,080,843	2.47
U.S. Govt. Agency MBS	1,843,914	10,720	(1,486)	1,853,148	3.02
Non-Agency Whole Loans	292,538	8	(1)	292,545	2.68
Commercial MBS	—	—	—	—	—
Asset backed Securities	21,926	3	(8)	21,921	2.60
Total Investment Securities	$ 3,268,042	$13,778	$ (3,406)	$ 3,278,414	2.80%

December 31, 2003	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 229,881	$ —	$ (2)	$ 229,879	1.10%
U.S. Govt. GNMA MBS/CMOs	910,675	3,154	(2,653)	911,176	1.99
U.S. Govt. Agency MBS	1,626,361	14,272	(6,218)	1,634,415	2.51
Non-Agency Whole Loans	20,281	1	(7)	20,275	1.49
Commercial MBS	1,717	—	—	1,717	1.39
Asset backed Securities	35,288	3	(37)	35,254	1.49
Total Investment Securities	$ 2,824,203	$17,430	$ (8,917)	$ 2,832,716	2.21%

December 31, 2002	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 259,807	$ 13	$ —	$ 259,820	1.51%
U.S. Govt. GNMA MBS/CMOs	823,773	4,825	(2,022)	826,576	2.37
U.S. Govt. Agency MBS	944,882	16,084	(698)	960,268	4.44
Non-Agency Whole Loans	37,954	178	(233)	37,899	3.53
Commercial MBS	3,241	—	(5)	3,236	1.64
Asset backed Securities	65,467	6	(154)	65,319	1.72
Total Investment Securities	$ 2,135,124	$21,106	$ (3,112)	$ 2,153,118	3.17%

AgFirst's investments consist primarily of mortgage backed securities (MBSs), asset backed securities (ABSs), and short term money market securities. MBSs are collateralized by U.S. Government or U.S. agency guaranteed residential mortgages and have a AAA credit rating. ABSs are also rated AAA due to the senior/subordinate structure and/or a credit wrap by a bond insurer. Money market securities are short term in nature (from overnight maturities to maturities that range from 30 to 90 days) and are only purchased from financial institutions that carry sound credit ratings. All unrealized losses referenced above are related to changes in interest rates and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category and the length of time the securities have been in a continuous unrealized position at December 31, 2004. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. The Bank has both the ability and the intent to recover substantially all of the cost in these investments.

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$ 585,002	$ 2,881	$ 98,069	$ 341
Other asset-backed securities	11,161	8	—	—
Total	$ 596,163	$ 2,889	$ 98,069	$ 341

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2004, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ 29,957	$ 29,957	2.35%
After one year through five years	—	—	—
After five years through ten years	—	—	—
After ten years	806,851	817,406	2.76
Collateralized mortgage obligations	2,431,234	2,431,051	2.48
Total	$ 3,268,042	$ 3,278,414	2.80%

Substantially all collateralized mortgage obligations have contractual maturities in excess of ten years. However, expected maturities for collateralized mortgage obligations will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from and realized gains and losses on investments in debt securities are as follows:

	Year Ended December 31, 2004	2003	2002
Proceeds on sales	$ 197,340	$ 69,242	$ 92,510
Realized gains	3,368	247	2,035
Realized losses	23	—	3,423

Notes to the Consolidated Financial Statements (continued)

Note 5 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2004	2003	2002
Direct notes receivable from District Associations	$ 11,229,197	$ 10,592,325	$ 10,033,923
Participations, net	1,374,863	1,554,762	1,631,311
Mortgage loans purchased In the secondary market	302,226	228,046	344,383
SFAS No. 133 Adjustment	63	(282)	(2,176)
Loans to Other Financing Institutions	1,900	500	600
Total	$ 12,908,249	$ 12,375,351	$ 12,008,041

A substantial portion of the Bank's loan portfolio consists of notes receivable from District Associations. As described in Note 1(B) — *Operations*, these notes are used by the Associations to fund their loan portfolios, and therefore, the Bank's concentration of credit risk in various agricultural commodities approximates that of the District as a whole. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. While the amounts below represent the Associations' maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Associations' lending activities is collateralized and the Associations' exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Bank's credit risk exposure is considered in the Bank's allowance for loan losses.

Total Association loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	**2004**	**2003**	**2002**
Poultry	13%	13%	13%
Forestry	12	12	11
Cattle	9	9	8
Fruits/Vegetables	9	5	5
Grain	8	10	9
Dairy	8	8	7
Nursery/Greenhouse	5	5	5
Processing	4	4	5
Rural Home	4	4	4
Tobacco	4	4	4
Swine	3	3	4
Cotton	3	3	4
Citrus	2	3	4
Other	16	17	17
Total	100%	100%	100%

Impaired loans are loans in which it is probable that principal and interest will not be collected according to the contractual terms. Interest income recognized and cash payments received on nonaccrual impaired loans are applied as described in Note 2.

The following table presents information relating to the Bank's impaired loans.

	December 31, 2004	2003	2002
Nonaccrual:			
Current as to principal and interest	$ 26,077	$ 11,401	$ 20,097
Past due	351	20,017	3,466
Accrual:			
Restructured	—	—	—
90 days or more past due	245	608	3,806
Total impaired loans	$ 26,673	$ 32,026	$ 27,369

The average recorded investment in impaired loans during 2004, 2003 and 2002 was $29,882, $31,619 and $28,868, respectively. Impaired loans of $26,428, $31,418 and $23,563 at December 31, 2004, 2003 and 2002 had a specific allowance for loan losses totaling $14,800, $12,700 and $6,000, respectively.

A summary of changes in the allowance for loan losses, all of which relates to the Bank's participation loan portfolio, follows:

	Year Ended December 31, 2004	2003	2002
Balance at beginning of year	$ 34,168	$ 31,155	$ 25,616
Provision for loan losses	—	2,500	8,000
Reversal of provision due to change in methodology	(15,292)	—	—
Loans charged off	(4,098)	(67)	(2,522)
Recoveries	22	580	61
Balance at end of year	$ 14,800	$ 34,168	$ 31,155

To mitigate risk of loan losses, District Associations have entered into long-term standby commitments to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac) through an arrangement with the Bank. The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Associations the right to sell the loans identified in the agreements to the Bank, which can, in turn, sell them to Farmer Mac in the event of default, subject to certain conditions. The balance of loans under long-term standby commitments to purchase was $398 million at December 31, 2004. Fees paid to Farmer Mac for such commitments are paid by the Associations. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $628 thousand, $96 thousand and $842 thousand for 2004, 2003 and 2002, respectively.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2004	2003	2002
Land	$ 896	$ 848	$ 848
Buildings and improvements	5,707	3,932	3,300
Furniture and equipment	37,844	30,750	28,002
Work in progress	7,760	7,895	3,048
	52,207	43,425	35,198
Less: accumulated depreciation	24,287	18,430	16,476
Total	$ 27,920	$ 24,995	$ 18,722

Note 7 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31, 2004	2003	2002
Other assets:			
Prepaid retirement expenses	$ 23,259	$ —	$ —
Unamortized debt issue costs	9,054	9,109	7,168
Intangible asset related to pension	—	1,583	1,797
Deferred issuance costs – preferred stock	3,385	3,974	2,331
Derivative assets	1,125	3,484	1,920
Receivables and other	32,998	29,070	26,196
Total	$ 69,821	$ 47,220	$ 39,412
Other liabilities:			
Accounts payable	$ 3,030	$ 2,349	$ 1,378
Farm Credit System Ins. Corp. payable	7,058	16,171	4,047
Derivative liabilities	11,278	3,188	6,295
Other	7,990	6,611	18,080
Total	$ 29,356	$ 28,319	$ 29,800

Note 8 — Bonds and Notes

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued by the Banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide Debt Securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets, at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the banks. In 1994, the System banks and the Funding Corporation entered into the Market Access Agreement (MAA), which established criteria and procedures for the banks to provide certain information and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. The MAA was amended and restated in July, 2003.

At December 31, 2004, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide Debt Securities.

Each issuance of Systemwide Debt Securities ranks equally, in accordance with the FCA regulations, with other unsecured Systemwide Debt Securities. Systemwide Debt Securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide Debt Securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The System may issue the following types of Systemwide Debt Securities:

- Federal Farm Credit Banks Consolidated Systemwide Bonds,
- Federal Farm Credit Banks Consolidated Systemwide Discount Notes,
- Federal Farm Credit Banks Consolidated Systemwide Master Notes,
- Federal Farm Credit Banks Global Debt Securities, and
- Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes.

For a discussion of the various risks, tax and other considerations, and terms and conditions related to each of these types of securities, see the discussions in the following offering circulars (available on the Funding Corporation's website located at *www.farmcredit-ffcb.com*), as applicable:

- The Federal Farm Credit Banks Consolidated Systemwide Bonds and Discount Notes Offering Circular dated June 18, 1999, as most recently amended by the supplement dated August 20, 2001,
- The Federal Farm Credit Banks Consolidated Systemwide Master Notes Offering Circular dated December 21, 1999, as most recently amended by the supplement dated August 20, 2001,
- The Federal Farm Credit Banks Global Debt Program Offering Circular dated October 10, 1996, which has not been amended by any supplements, and
- The Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes Offering Circular dated July 19, 1993, as most recently amended by the supplement dated June 11, 1999.

Each of these offering circulars may be further amended or supplemented from time to time. In addition, the Banks may in the future offer new types of Systemwide Debt Securities; the offering of any such securities will be pursuant to additional offering circulars.

AgFirst's participation in outstanding Systemwide Debt Securities is as follows:

	Bonds		Medium-Term		Discount Notes		Total	
	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount
2005	2.04%	$ 4,651,483	—%	$ —	2.10%	$ 1,670,076	2.06%	$ 6,321,559
2006	2.38	3,823,543	6.75	15,806	—	—	2.40	3,839,349
2007	2.88	1,709,831	—	—	—	—	2.88	1,709,831
2008	3.27	1,529,485	—	—	—	—	3.27	1,529,485
2009	3.58	681,121	—	—	—	—	3.58	681,121
2010	4.66	1,321,040	—	—	—	—	4.66	1,321,040
Total	2.71%	$ 13,716,503	6.75%	$ 15,806	2.10%	$ 1,670,076	2.65%	$ 15,402,385

Notes to the Consolidated Financial Statements (continued)

In the preceding table, weighted average interest rates include the effect of related derivative financial instruments.

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2004, was 29 days.

Systemwide debt includes callable bonds and medium-term notes consisting of the following:

Amount	First Call Date	Year of Maturity
$ 6,556,000	2005	2005-2018
6,000	2006	2008
$ 6,562,000		

Callable debt may be called on the first call date and, any time thereafter.

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide Debt Securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund. All other liabilities on the financial statements are uninsured. At December 31, 2004 the assets of the Insurance Fund aggregated $2.164 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund will be used to repay the Financial Assistance Corporation debt issued to fund the purchase of $374 million of Federal Land Bank of Jackson preferred stock. The Insurance Fund will cover funds not sufficient in the Financial Assistance Corporation Trust Fund (Trust Fund) upon maturity of debt. As of December 31, 2004, available funds in the Trust Fund amounted to $78.1 million.

Note 9 — Mandatorily Redeemable Preferred Stock

As of December 31, 2004, AgFirst had 225,000 shares issued and outstanding of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable semi-annually in arrears on the 15th day of June and December of each year at an annual rate equal to 8.393 percent of the $1 thousand per share par value together with accrued and unpaid dividends to the redemption date. Beginning March 15, 2012, the rate will change to a floating rate indexed to the 3-month LIBOR. On or after the dividend payment date in December 15, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of $1 thousand per share. Beginning July 1, 2003, the Mandatorily Redeemable Preferred Stock was required to be reported prospectively as a liability and the related dividends reported prospectively as interest expense in accordance with SFAS No. 150. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes.

Note 10 — Shareholders' Equity

Descriptions of the Bank's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Description of Equities:** In accordance with the Farm Credit Act and the Bank's capitalization bylaws, the Bank is authorized to issue and have outstanding Classes B, C and D Common Stock, Participation Certificates, Preferred Stock and other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Bank's business. All Common Stock and Participation Certificates have a par or face value of five dollars ($5.00) per share.

The Bank had the following shares of common equities outstanding at December 31, 2004:

		Shares Outstanding	
Class	Protected Status	Number	Aggregate Par Value
B Common/Nonvoting	No	2,138,600	$ 10,693
C Common/Voting	No	41,349,343	206,747
D Common/Nonvoting	No	1,736,857	8,684
Participation Certificates/Nonvoting	No	15,200	76
Total Capital Stock and Participation Certificates		45,240,000	$ 226,200

B. **Perpetual Preferred Stock:** On October 14, 2003, AgFirst issued 150,000 shares of Perpetual Non-Cumulative Preferred Stock. Dividends on the stock are payable at an annual rate equal to 7.30 percent. In the event dividends are not declared on the Preferred Stock for payment on any dividend payment date, then such dividends shall not cumulate and shall cease to accrue and be payable. On and after the dividend payment date in December 2008, the Bank may, at its option, redeem the Preferred Stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for the then current dividend period to the date of redemption.

Payment of dividends or redemption price on the Preferred Stock may be restricted if the Bank fails to satisfy applicable minimum capital adequacy, surplus and collateral requirements.

C. **Capital Stock:** District Associations are required to maintain ownership in the Bank in the form of Class B or C Common Stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

Additionally, the Bank has issued Class D Common Stock in connection with participations purchased by the Bank from other System institutions. Class D Common Stock issued in connection with participations has no voting rights. Such Stock may be retired at the discretion of the Board, and, if retired, shall be retired at book value, not to exceed its par value.

Class D Common Stock shall also be purchased by borrowers eligible to hold it as a condition for obtaining a loan in an amount as may be determined by the Board at its discretion within a range between a minimum of two percent (2%) of the loan amount or $1,000.00, whichever is less, and a maximum not to exceed ten percent (10%) of the loan amount. The Bank currently has no such loans outstanding.

D. **Other Equity:** At the inception of each Other Financing Institution (OFI) loan, the Bank requires OFIs to make cash purchases of participation certificates in the Bank. The Bank has a first lien on these equities for the repayment of any indebtedness to the Bank.

E. **Regulatory Capitalization Requirements and Restrictions:** FCA's capital adequacy regulations require the Bank to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven 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 Bank's consolidated financial statements. The Bank is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA Regulations also require all System institutions to achieve and maintain additional capital adequacy ratios as defined by FCA Regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Bank's permanent capital, total surplus and core surplus ratios at December 31, 2004 were 26.86 percent, 26.76 percent and 15.60 percent, respectively.

Capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104 percent compared to the regulatory minimum of 103 percent. At December 31, 2004, the Bank's net collateral ratio was 106.88 percent.

An 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 Bank has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

Note 11 — Employee Benefit Plans

The Bank participates in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Bank employees. For participants hired prior to January 1, 2003, benefits are based on eligible compensation and years of service. The assets, liabilities and 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. For participants hired on or after January 1, 2003, benefits are determined using a cash balance formula. This formula is based on employer contributions (3-5 percent of eligible compensation depending on years of service) and interest credits as allocated to an employee's theoretical account balance. The measurement date for the plan is September 30.

At December 31, 2003 and 2002, the Accumulated Benefit Obligation (ABO) of the District's defined benefit plan (the Plan) exceeded the fair value of plan assets, and accordingly, the recognition of a minimum liability in the amount of the excess of the ABO over the fair value of plan assets is required. At December 31, 2003 and 2002, a minimum liability for the Bank was recognized in the amounts of $8,751 and $10,449, respectively. The fair value of the plan assets and the ABO were measured as of September 30, 2004. No liability was required at December 31, 2004, as the fair value of plan assets exceeded the ABO.

The Bank also sponsors supplemental retirement and deferred compensation plans for highly compensated employees. The plans are nonqualified; therefore, the associated liabilities are included in the Bank's consolidated balance sheets in other liabilities. The expenses of these plans included in the Bank's retirement costs were $283, ($49) and $277 for the years ended December 31, 2004, 2003 and 2002, respectively.

The Bank also participates in a Districtwide Thrift Plan, which qualifies as a 401(k) plan as defined by Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Bank contributes $.50 for each $1.00 of the employee's first 6 percent of contribution up to the maximum employer contribution of 3 percent of total compensation. For employees hired on or after January 1, 2003, the Bank contributes $1.00 for each $1.00 of the employee's first 6 percent of contribution up to the maximum employer contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service.

In addition to providing pension benefits, the Bank provides certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all employees may become eligible for the benefits if they reach early retirement age while working for the Bank. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002 are required to pay the full cost of their retiree health insurance coverage.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position ("FSP") 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the "Act"). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004), and, accordingly, the benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act. For Medicare-eligible participants receiving actuarially equivalent drug benefits, the expected per capita claims cost are estimated to be reduced by 12 percent beginning in 2006 due to a government reimbursement of a portion of prescription drug benefits. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. Due to the status of the plan and the assumptions used in the remeasurement upon adoption of FSP 106-2, there was no effect on expense for 2004.

The following is a table of retirement and postretirement benefit expenses:

	2004	2003	2002
Pension	$ 3,858	$ 3,560	$ 2,452
Thrift/deferred compensation	500	425	383
Other postretirement benefits	2,631	2,595	2,025
Total	$ 6,989	$ 6,580	$ 4,860

Note 12 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation's issuance of $1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent.

The proceeds from the debt offerings were used to fund existing intra-System financial assistance payables ($417 million), to purchase preferred stock from certain troubled System banks ($808 million), and for other purposes ($36 million). Pursuant to the Farm Credit Act, the U.S. Treasury paid the interest on $844 million of the Financial Assistance Corporation bonds for the first five years of the respective terms of such bonds. The payment of interest on this debt was allocated between the U.S. Treasury and System banks during the second five years. As the result of growth of the System's surplus, the allocation provisions of the Farm Credit Act require that banks pay 100 percent of the interest beginning in 1999. The Farm Credit Act and supplemental agreements dictate how the banks will repay the principal and fund the interest of each type of issuance. With the exception of the assistance provided through the purchase of preferred stock, repayment of the Financial Assistance Corporation debt obligations will be allocated to all System banks, and annual expense accruals and funding assessments are generally allocated based on each bank's proportion of System loan volume over various time periods.

Notes to the Consolidated Financial Statements (continued)

Financial assistance was provided by the Financial Assistance Corporation to five System banks in other districts through its purchase of preferred stock of those institutions. Through 1994, four System banks redeemed their preferred stock in the amount of $419 million through the transfer of assets to the Financial Assistance Corporation, which were placed in trusts. The Federal Land Bank of Jackson, whose charter was canceled in January of 1995, received $374 million of financial assistance for which the related preferred stock has not been redeemed.

All interest advanced by the U.S. Treasury must be repaid by System banks in 2005. System banks record their share of the liability based upon each bank's proportionate share of average accruing retail loan volume. To fund the repayment obligation, annual annuity-type payments are made by each bank to the Financial Assistance Corporation in an amount designed to accumulate, in total, including earnings thereon, the total amount of each bank's ultimate obligation.

The Financial Assistance Corporation assumed certain payables previously accrued by the Bank under the System's Capital Preservation Agreements and funded payment of such accruals by the issuance of 15-year U.S. Treasury-guaranteed debt. Under the Farm Credit Act, the System banks are required to fund the bonds upon maturity. Although GAAP requires recognition in the consolidated financial statements of the Bank's liability to the Financial Assistance Corporation, the Farm Credit Act states that, for all financial reporting purposes, this obligation shall not be considered a liability of any System bank until the maturity of such debt. This debt matured on July 21, 2003. There is a statutorily mandated repayment plan, which effectively spreads the financial assistance payments and expenses over a number of years and accordingly gradually reduces the effect of the unrecorded liability. Management considers the current and future effect of not recording the liability to be immaterial to the Bank's financial condition and results of operations.

The Bank's financial assistance expense totaled $7 million, $13 million and $15 million in 2004, 2003 and 2002, respectively.

Note 13 — Related Party Transactions

As discussed in Note 1, the Bank lends funds to the District Associations to fund their loan portfolios. Further disclosure regarding these related party transactions is found in Notes 5, 10 and 15.

Interest income recognized on direct notes receivable from District Associations was $400,200, $396,136 and $438,233 for 2004, 2003 and 2002, respectively.

Note 14 — Regulatory Enforcement Matters

At December 31, 2004, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 15 — Commitments and Contingencies

The Bank has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to the consolidated financial statements. While primarily liable for its portion of bonds and notes, the Bank is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2004, were $99.1 billion.

In the normal course of business, the Bank may participate in credit related financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers or the borrowers of the District Associations. These financial instruments include standby letters of credit, various guarantees and commitments to extend credit.

Standby letters of credit are unconditional commitments issued by the Bank to guarantee the performance of a customer to a third party. As of December 31, 2004, the Bank had $24.6 million letters of credit issued on behalf of Association customers. Of the outstanding amount, $13.9 million will expire in less than one year, $10.3 million are due to expire in one to three years and the remaining $456 thousand have terms that will expire in 2011. The Bank also guarantees letters of credit with commercial banks on behalf of certain District Associations in the amount of $8.9 million.

In addition, the Bank had $71.4 million in letters of credit issued on behalf of non-district entities with $916 thousand expiring in less than one year, $39.8 million due to expire in one to three years and the remaining $30.7 million have terms that will expire from 2008 to 2010.

The Bank also guarantees certain loans held by District Associations in the amount of $27.3 million with $21.5 million expiring in less than one year and the remaining $5.8 million will expire in 2024. The notional amounts of these guarantees represent the maximum amount of exposure the Bank has related to these instruments as of December 31, 2004.

At December 31, 2004, $1.087 billion of commitments to extend credit were outstanding. 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 financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. 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 loan collateral 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.

As of December 31, 2004, AgFirst also indemnifies leases in the amount of $3.6 million on behalf of the Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

Other actions are pending against the Bank in which claims for money damages are asserted. On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from these other actions, would not be material in relation to the financial position of the Bank.

Note 16 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Bank's financial instruments at December 31, 2004, 2003 and 2002. 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.

	December 31, 2004		December 31, 2003		December 31, 2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$ 12,908,249	$ 12,519,613	$ 12,375,351	$ 11,742,568	$ 12,008,041	$ 11,924,081
Allowance for loan losses	(14,800)	—	(34,168)	—	(31,155)	—
Loans, net	$ 12,893,449	$ 12,519,613	$ 12,341,183	$ 11,742,568	$ 11,976,886	$ 11,924,081
Derivative assets	$ 1,125	$ 1,125	$ 3,484	$ 3,484	$ 1,920	$ 1,920
Cash & investment securities	$ 3,748,672	$ 3,748,672	$ 3,302,661	$ 3,302,661	$ 2,512,937	$ 2,512,937
Financial liabilities:						
Systemwide Debt Securities	$ 15,402,385	$ 15,206,435	$ 14,507,105	$ 14,475,670	$ 13,538,536	$ 13,223,005
Financial assistance related liabilities*	$ (1,322)	$ (609)	$ 78	$ 2,660	$ 8,087	$ 10,918
Derivative liabilities	$ 11,278	$ 11,278	$ 3,188	$ 3,188	$ 6,295	$ 6,295

* *The above amount excludes the assumption of Third Quarter 1986 Capital Preservation Agreement obligations with a fair value of $6.8 million at December 31, 2002. The obligation was paid in July 2003.*

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

A. **Loans:** Because no active market exists for the Bank's loans, fair value is estimated by discounting the expected future cash flows using the Bank's current interest rates at which similar loans would be made to borrowers with similar credit risk. Since 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 values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. The carrying value of accrued interest approximates its fair value.

B. **Cash, Federal Funds and Securities Purchased Under Resale Agreements:** The carrying value is a reasonable estimate of fair value.

C. **Investment Securities:** Fair value is based upon currently quoted market prices.

D. **Systemwide Debt Securities:** Bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity Treasury notes, assuming a constant estimated spread relationship between Systemwide bonds and notes and comparable Treasury notes.

E. **Financial Assistance Related Liabilities:** As discussed in Note 12, the District is liable for certain obligations of the Financial Assistance Corporation, one of which is unrecorded. Fair value of these obligations is determined by discounting the cumulative expected future cash outflows of all of the obligations using an interest rate commensurate with bonds having a similar maturity.

F. **Derivative Instruments:** The fair value of derivatives is the estimated amount to be received or paid to replace the instruments at the reporting date, considering current and projected interest rates. Where actively quoted market prices do not exist, estimated fair values are determined through dealer quotes.

G. **Commitments to Extend Credit and Standby Letters of Credit:** The fair value of commitments is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreement and the creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on an estimate of the cost to terminate the agreement or fees currently charged for similar agreements. The estimated market value of off-balance-sheet commitments is considered to be nominal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is also considered not to be significant.

Note 17 — Derivative Instruments and Hedging Activities

The Bank maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the Bank's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the Bank's gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The Bank considers its strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

Notes to the Consolidated Financial Statements (continued)

The Bank enters into derivatives, particularly interest rate swaps, to lower funding costs, diversify sources of funding, or alter interest rate exposures arising from mismatches between assets and liabilities. Interest rate swaps allow the Bank to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the Bank if floating rate borrowings were made directly. Under interest rate swap arrangements, the Bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating rate index.

The Bank may purchase interest rate options such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on its floating-rate assets. There are no floors outstanding currently.

By using derivative instruments, the Bank exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the Bank's credit risk will equal the fair value gain in the derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the Bank, thus creating a repayment risk for the Bank. When the fair value of the derivative contract is negative, the Bank owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the Bank deals with counterparties that have an investment grade credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. The estimated credit risk exposure of $1.3 million with seven counterparties represents approximately 0.04 percent of the total notional amount of interest rate swaps. The Bank does not anticipate nonperformance by any of these counterparties. The Bank typically enters into master agreements that contain netting provisions. These provisions allow the Bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. A number of swaps are supported by collateral arrangements with counterparties. At December 31, 2004, the Bank had not posted collateral with respect to these arrangements.

The Bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of ALCO's oversight of the Bank's asset/liability and treasury functions. The Bank's ALCO is responsible for approving hedging strategies that are developed through its analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the Bank's overall interest rate risk-management strategies.

Note 18 — Additional Derivative Financial Instruments and Other Financial Instruments Disclosures

The table below provides information about derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. The debt information below represents the principal cash flows and related weighted average interest rates by expected maturity dates. The derivative information below represents the notional amounts and weighted average interest rates by expected maturity dates.

	Maturities of 2004 Derivative Products and Other Financial Instruments							
December 31, 2004 *(dollars in millions)*	**2005**	**2006**	**2007**	**2008**	**2009**	**After 2010**	**Total**	**Fair Value**
Systemwide Debt Securities:								
Fixed rate	$ 3,634	$ 2,078	$ 1,288	$ 1,254	$ 480	$ 1,318	$ 10,052	$ 9,998
Weighted average interest rate	1.93%	2.49%	3.06%	3.47%	4.09%	4.66%	3.28%	
Variable rate	2,540	1,759	421	274	200	—	5,194	5,208
Weighted average interest rate	2.29%	2.29%	2.31%	2.36%	2.33%	—	1.93%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 25	$ 590	$ 350	$ 390	$ —	$ —	$ 1,355	$ (10)
Weighted average receive rate	1.74%	2.51%	2.99%	3.51%	—	—	2.91%	
Weighted average pay rate	2.29%	2.26%	2.27%	2.27%	—	—	2.26%	
Amortizing floating for floating swaps								
Notional value	213	287	—	—	—	—	500	—
Weighted average receive rate	2.39%	1.55%	—	—	—	—	1.91%	
Weighted average pay rate	2.79%	1.45%	—	—	—	—	2.02%	
Interest rate caps								
Notional value	1,555	251	—	—	—	—	1,806	—
Total notional value	$ 1,793	$ 1,128	$ 350	$ 390	$ —	$ —	$ 3,661	$ (10)
Total weighted average rates on swaps:								
Receive rate	2.32%	2.19%	2.99%	3.51%	—	—	2.64%	
Pay rate	2.73%	1.99%	2.27%	2.27%	—	—	2.20%	

Note 19 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2004, 2003 and 2002 follow:

2004	First	Second	Third	Fourth	Total
Net interest income	$ 54,801	$ 54,781	$ 53,340	$ 48,673	$ 211,595
Provision for (reversal of) loan losses	—	—	—	(15,292)	(15,292)
Noninterest income (expense), net	(7,948)	(11,625)	(12,987)	(14,021)	(46,581)
Net income	$ 46,853	$ 43,156	$ 40,353	$ 49,944	$ 180,306

2003	First	Second	Third	Fourth	Total
Net interest income	$ 66,320	$ 65,563	$ 56,168	$ 56,006	$ 244,057
Provision for loan losses	2,500	—	—	—	2,500
Noninterest income (expense), net	(12,663)	(19,981)	(17,658)	(13,806)	(64,108)
Net income	$ 51,157	$ 45,582	$ 38,510	$ 42,200	$ 177,449

2002	First	Second	Third	Fourth	Total
Net interest income	$ 61,108	$ 63,104	$ 64,775	$ 66,673	$ 255,660
Provision for loan losses	1,000	1,000	—	6,000	8,000
Noninterest income (expense), net	(16,648)	(10,961)	(15,989)	(9,929)	(53,527)
Net income	$ 43,460	$ 51,143	$ 48,786	$ 50,744	$ 194,133

Note 20— Combined Associations Financial Data (Unaudited)

Condensed financial information of the combined Associations follows. All significant transactions and balances between the Associations are eliminated in combination.

Balance Sheet

	December 31, 2004	2003	2002
Cash	$ 52,604	$ 57,306	$ 75,434
Loans	13,169,758	12,552,758	11,902,688
Less: allowance for loan losses	80,619	282,567	280,025
Net loans	13,089,139	12,270,191	11,622,663
Investment in other Farm Credit institutions	217,467	217,051	237,051
Other assets	450,359	308,493	320,588
Total assets	$ 13,809,569	$ 12,853,041	$12,255,736
Notes payable to AgFirst Farm Credit Bank	$ 11,229,198	$ 10,592,326	$10,085,054
Postretirement benefits other than pensions	79,026	67,085	56,680
Minimum pension liability	—	48,408	51,373
Other liabilities	251,877	263,309	241,167
Total liabilities	11,560,101	10,971,128	10,434,274
Protected borrowers equity	10,124	12,453	15,486
Capital stock and participation certificates	174,773	175,581	171,663
Retained earnings			
Allocated	849,626	792,168	756,525
Unallocated	1,215,344	984,384	968,171
Accumulated other comprehensive (loss)	(399)	(82,673)	(90,383)
Total shareholders' equity	2,249,468	1,881,913	1,821,462
Total liabilities and equity	$ 13,809,569	$ 12,853,041	$12,255,736

Statement of Income

	Year Ended December 31, 2004	2003	2002
Interest income	$ 753,222	$ 723,994	$ 734,649
Interest expense	400,334	396,227	441,242
Net interest income	352,888	327,767	293,407
Provision for (reversal of) loan losses	(198,096)	5,653	17,263
Net interest income after provision for loan losses	550,984	322,114	276,144
Noninterest income	166,774	135,931	123,025
Noninterest expenses			
Salaries and employee benefits	157,407	150,476	129,971
Occupancy and equipment	16,623	15,951	15,782
Insurance Fund Premium	6,244	14,166	3,414
Other operating expenses	48,764	44,964	43,418
Total noninterest expenses	229,038	225,557	192,585
Income before income taxes	488,720	232,488	206,584
Provision (benefit) for income taxes	10,363	858	4,183
Net income	$ 478,357	$ 231,630	$ 202,401

The 2004 net income of the combined Associations included $188.9 million, net of $11.2 million tax impact for the one-time reversal of the allowance for loan losses due to the refinement of methodologies. Excluding the one-time reversal of the allowance for loan losses, net income for the combined Associations would have been $289.5 million for 2004.

AgFirst Leadership

Management

F. A. (Andy) Lowrey	President and Chief Executive Officer
Thomas S. Welsh	Executive Vice President, Chief Administrative and Legislative Officer & Corporate Secretary
William R. Clayton	Senior Vice President, Lending & Operations Officer
Leon T. Amerson	Senior Vice President & Chief Financial Officer
Benjamin F. Blakewood	Senior Vice President, Chief Information Officer

Board of Directors as of January 1, 2005

E. McDonald Berryman	Chairman
Robert G. Sexton	Vice Chairman
William C. Bess, Jr.	Director
Dr. Chester D. Black	Director
Robert A. Carson	Director
Henry M. Frazee	Director
Don W. Freeman	Director
Robert L. Holden, Sr.	Director
Paul M. House	Director
Thomas W. Kelly	Director
Lyle Ray King	Director
Richard Kriebel	Director
M. Wayne Lambertson	Director
Paul Lemoine	Director
F. Merrel Lust	Director
Eugene W. Merritt, Jr.	Director
Dale W. Player	Director
J. Dan Raines, Jr.	Director
Walter L. Schmidlen, Jr.	Director

WRITER & EDITOR *joy upchurch* ■ ART DIRECTION & DESIGN *donna camacho* ■ PHOTOGRAPHY *jeff amberg*

FINANCIAL REPORTING
wanda martin | *jay wise* | *gloria hawkins* | *anita alexander* | *deborah lucas* | *johnna randolph*

AgFirst
Farm Credit Bank

PO Box 1499 ■ Columbia, SC 29202 ■ www.agfirst.com