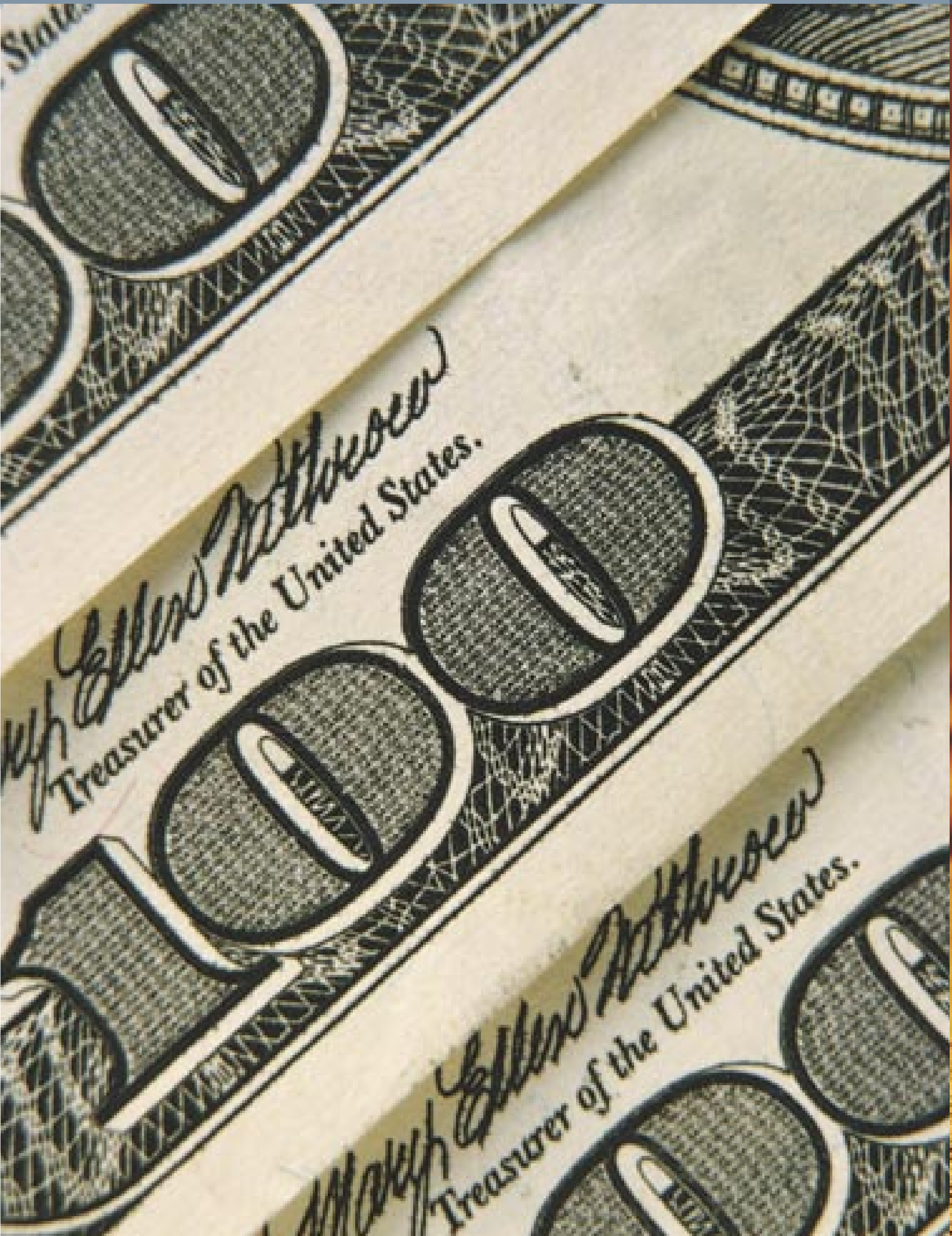
AgFirst Farm Credit Bank
& District Associations

ANNUAL REPORT 2004



AgFirst Farm Credit Bank and District Associations

2004 ANNUAL REPORT

Contents

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 Technology & Operations Officer

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Message from the Chairman of the Board and Chief Executive Officer

Dear Shareholders:

**Growing loan volume…Healthy market share…Good credit quality…
Record profits…Substantial distributions to our borrowers…**

The business model adopted by the AgFirst family many years ago is serving us well. This powerful model is based upon the simple concepts of cooperation:

- **AgFirst Farm Credit Bank**, operating on a cooperative basis, provides funding and operational support to the 23 affiliated associations. This centralization affords each association access to high quality systems and products at a level of efficiency that far exceeds that which could be achieved individually — without compromising their individuality.

- **The Associations,** operating on a cooperative basis, provide competitive loan products and related services to their borrower/owners.

- The combined synergy of the Associations and AgFirst Farm Bank, combined with sound business practices, results in a patronage dividend stream that substantially reduces the borrowing costs of our owner/borrowers.

- The benefits of cooperative ownership continue to attract new customers, create loyalty, and differentiate us in the marketplace.

It's a perfect circle. And it produced the following results in 2004:

- Net income was a record $535.2 million. While this amount includes a one-time reversal of allowance for loan losses of $215.4 million (discussed fully in this report), our net income would have been a record $319.8 million without this item.

- Distributions totaled $171 million — an increase of more than 7.0% from 2003.

- Association loan volume increased 4.92% to $13.2 billion at year-end.

- According to FDIC reports as of September 30, 2004, the Associations enjoyed a 53.8% share of the agricultural loan market as compared to commercial banks headquartered in the district.

- 94.5% of the Associations' loans were classified "acceptable" at year-end — the highest level reported in three years.

Many factors have contributed to the district's success in recent years. One important factor is our focus on creating efficiencies through the wise use of technology. Recently introduced products, such as a proprietary loan processing system and a web-based tool developed for credit scoring small, low-risk loans, are examples of this focus. These technologies, and others, have enabled associations to grow significantly while keeping staff levels relatively flat. Since 1997, the Associations have added more than $5.0 billion in loan volume, while increasing staff by only 1.5%.

Our emphasis on efficiency means more money is available to pay dividends and fund the needs of rural America. That's why AgFirst and the Associations worked together in 2004 to identify several new initiatives aimed at further improving efficiency. Collectively, these initiatives, called the Business Integration Projects, will also result in better customer service, which is our ultimate goal.

Our work on the Business Integration Projects is just one example of the tremendous spirit of cooperation that exists between AgFirst and the Associations and our owners/borrowers.

This spirit was never more evident than when five hurricanes hit the Southeastern coasts in August and September of 2004. Good emergency planning, along with the efforts of dedicated employees (many whose own homes were damaged or destroyed), allowed the Associations to quickly recover and resume their business of meeting the needs of their borrower/owners. Additionally, our family of Farm Credit employees contributed more than $140 thousand to help employees rebuild their homes and their lives.

Such is the spirit of the AgFirst Family. Whether we're working together to improve customer service, or engaged in an effort to aid our fellow employees, this spirit of cooperation is deeply embedded in our culture. It is this spirit that is the basis of our outstanding financial results and the foundation for our future success.

E. McDonald Berryman
Chairman of the Board

F. A. (Andy) Lowrey
Chief Executive Officer

March 7, 2005

Report of Management

The accompanying financial statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (AgFirst) 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 financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of AgFirst 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 AgFirst Farm Credit District 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 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 financial statements have been examined by independent public accountants, whose report appears elsewhere in this annual report. AgFirst and Associations are also subject to examination by the Farm Credit Administration.

The financial statements, in the opinion of management, fairly present the financial condition of AgFirst and Associations. 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 7, 2005

Five-Year Summary of Selected Combined Financial Data

(UNAUDITED)

(dollars in thousands)	December 31, 2004	2003	2002	2001	2000
Combined Balance Sheet Data					
Cash and cash equivalents	$ 522,862	$ 527,250	$ 444,457	$ 339,541	$ 326,204
Investment securities, available for sale	3,278,414	2,832,716	2,153,118	1,663,323	2,000,086
Loans	14,848,831	14,336,779	13,823,089	12,877,889	11,095,176
Less: allowance for loan losses	95,419	316,735	311,180	301,615	284,867
Net loans	14,753,412	14,020,044	13,511,909	12,576,274	10,810,309
Other property owned	3,433	2,253	4,828	5,925	6,369
Other assets	437,295	313,654	312,689	376,630	379,453
Total assets	$ 18,995,416	$ 17,695,917	$ 16,427,001	$ 14,961,693	$ 13,522,421
Obligations with maturities of one year or less	$ 6,586,537	$ 6,482,632	$ 6,357,834	$ 8,101,242	$ 6,646,015
Obligations with maturities greater than one year	9,184,234	8,426,554	7,562,772	4,354,069	4,715,193
Mandatorily redeemable preferred stock	225,000	225,000	—	—	—
Total liabilities	15,995,771	15,134,186	13,920,606	12,455,311	11,361,208
Mandatorily redeemable preferred stock	—	—	225,839	225,839	—
Perpetual preferred stock	150,000	150,000	—	—	—
Protected borrower equity	10,123	12,453	15,486	19,261	23,634
Capital stock and participation certificates	125,089	128,099	124,541	127,271	132,856
Retained earnings					
Allocated	849,626	792,168	756,525	733,378	704,010
Unallocated	1,861,476	1,587,934	1,494,659	1,393,592	1,302,163
Accumulated other comprehensive income (loss)	3,331	(108,923)	(110,655)	7,041	(1,450)
Total shareholders' equity	2,999,645	2,561,731	2,280,556	2,280,543	2,161,213
Total liabilities and shareholders' equity	$ 18,995,416	$ 17,695,917	$ 16,427,001	$ 14,961,693	$ 13,522,421
Combined Statement of Income Data					
Net interest income	$ 568,826	$ 575,913	$ 553,058	$ 484,332	$ 440,656
Provision for (reversal of) loan losses	(213,388)	8,153	25,263	20,296	7,619
Noninterest income (expense), net	(247,003)	(248,129)	(215,248)	(160,795)	(198,460)
Net income	$ 535,211	$ 319,631	$ 312,547	$ 303,241	$ 234,577
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	2.96%	1.88%	2.04%	2.15%	1.85%
Total shareholders' equity	19.31%	13.03%	13.28%	13.67%	11.05%
Net interest income as a percentage of average earning assets	3.16%	3.40%	3.63%	3.46%	3.50%
Net chargeoffs (recoveries) to average loans	0.05%	0.02%	0.12%	0.03%	0.02%
Total shareholders' equity to total assets	15.79%	14.48%	13.88%	15.24%	15.98%
Debt to shareholders' equity (:1)	5.33	5.91	6.10	5.46	5.26
Allowance for loan losses to loans	0.64%	2.21%	2.25%	2.34%	2.57%
Permanent capital ratio (Bank only)	26.86%	25.99%	22.91%	20.70%	16.92%
Total surplus ratio (Bank only)	26.76%	25.79%	22.69%	19.86%	15.50%
Core surplus ratio (Bank only)	15.60%	14.45%	13.20%	10.39%	10.42%
Collateral ratio (Bank only)	106.88%	106.94%	105.94%	106.38%	104.95%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 80,466	$ 67,792	$ 64,846	$ 70,621	$ 61,185
Qualified allocated surplus	28,684	46,636	50,936	75,336	115,986
Nonqualified allocated surplus	65,666	47,154	42,261	29,946	4,634
Nonqualified retained surplus	74,467	48,391	32,402	21,165	—
Stock dividends	60	84	90	274	276
Mandatorily redeemable preferred stock dividend	—	10,282	18,887	10,912	—
Perpetual preferred stock dividend	10,950	1,851	—	—	—

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

(dollars in thousands, except as noted)

This commentary reviews the combined financial condition and results of operations of AgFirst Farm Credit Bank (AgFirst or the Bank) and the District Agricultural Credit Associations (ACAs or Associations), collectively referred to as the District. This information should be read in conjunction with the accompanying combined financial statements, the notes to the combined financial statements, and other sections of this annual report.

Operating Structure

The District is part of the Farm Credit System (the System), the country's oldest Government Sponsored Enterprise (GSE), created by Congress to provide sound, adequate, and constructive credit and closely related services to agriculture and rural America.

AgFirst and each Association are Federally chartered instrumentalities of the United States and are individually regulated by the Farm Credit Administration (the FCA). In creating the System, it was the stated objective of Congress to "*encourage farmer- and rancher-borrowers' participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System."* Consequently, the Associations are structured as cooperatives; that is, each Association is owned by its borrowers. As such, the benefits of ownership flow to the same farmer/rancher-borrowers that the System was created to serve. Additional information related to the Associations' structure is discussed in Note 1, *Organization and Operations,* of the notes to the combined financial statements in this annual report to shareholders.

As of December 31, 2004, the District was comprised of AgFirst, its wholly owned subsidiary (the Farm Credit Finance Corporation of Puerto Rico), and twenty-three Agricultural Credit Associations (the Associations). AgFirst and the Farm Credit Finance Corporation of Puerto Rico provide funding and related services to the twenty-three Associations which, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the twenty-three Associations, a revolving line of credit, referred to as a *direct note*. Each Association funds its lending and general corporate activities by borrowing through its direct note. All assets of the Associations secure the direct notes and lending terms are specified in a separate General Financing Agreement between AgFirst and each Association. AgFirst also operates as a cooperative and is owned by the twenty-three Associations.

AgFirst and the Associations are chartered to serve eligible borrowers in Alabama, Delaware, Florida, Georgia, Maryland, Mississippi, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia, Puerto Rico, and portions of Kentucky, Louisiana, Ohio, and Tennessee. Three other Farm Credit Banks and an Agricultural Credit Bank, through a number of associations, provide loans and related services to eligible borrowers in the remaining portion of the United States. While owned by its related associations, each Farm Credit Bank manages and controls its own business activities and operations. Likewise, associations are not commonly owned or controlled and each manages and controls its own business activities and operations. Nevertheless, each Farm Credit Bank and its related associations operate in such an interdependent manner that the financial results of each bank are generally viewed on a combined basis with its related associations.

While combined District statements reflect the financial and operational interdependence of AgFirst and the Associations, it is recognized that AgFirst does not own or control the Associations and has limited access to Association capital. Therefore, Bank-only financial information (e.g. not combined with the Associations) has been set forth in Note 21, *Bank Only Financial Data* in the Notes to the Combined Financial Statements for the purposes of additional analysis. In addition, AgFirst publishes a Bank-only financial report that may be referred to for a more complete analysis of AgFirst Bank-only financial condition and results of operations.

Financial Condition

Loans

The District's aggregate loan portfolio primarily consists of direct loans made by the Associations to eligible borrowers located within their chartered territories, as illustrated in the following table.

	2004	
	$	%
Association-originated loans	$ 13,651,198	92%
Loan participations purchased	2,529,975	17
Loan participations sold	(1,662,608)	(11)
Other	330,266	2
Total	$ 14,848,831	100%

	2003	
	$	%
Association-originated loans	$ 13,014,370	91%
Loan participations purchased	2,759,840	19
Loan participations sold	(1,699,159)	(12)
Other	261,728	2
Total	$ 14,336,779	100%

	2002	
	$	%
Association-originated loans	$ 12,295,709	89%
Loan participations purchased	2,746,347	20
Loan participations sold	(1,565,235)	(11)
Other	346,268	2
Total	$ 13,823,089	100%

Loans outstanding as of December 31, 2004 totaled $14.8 billion, an increase of 3.57 percent and 7.42 percent compared to December 31, 2003 and 2002, respectively. District loan growth in origination is attributable to a seasoned lending staff, the value inherent to patronage paid under its cooperative structure, the direct and indirect payments to 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.

The District employs a number of risk management techniques to limit credit exposures. AgFirst and each Association have 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 utilize guarantees from other agencies, including Fannie Mae, Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Services Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2004, the District collectively had $1.4 billion of guaranteed principal under various government or GSE guarantee programs.

The Associations serve all or a portion of fifteen states and Puerto Rico. Additionally, AgFirst and the Associations actively participate in the purchase and sale of loans and loan participations with non-District institutions. The resulting geographic dispersion is a natural risk-reducing factor. The following table illustrates the geographic distribution of the aggregate District portfolio.

State	2004	2003	2002
North Carolina	15%	16%	17%
Florida	15	14	14
Georgia	12	11	11
Virginia	11	11	11
Pennsylvania	10	10	10
Maryland	7	6	6
South Carolina	6	7	7
Ohio	4	4	4
Alabama	3	3	3
Kentucky	3	3	2
Delaware	2	2	2
Mississippi	2	2	2
West Virginia	2	2	2
Puerto Rico	1	1	1
Louisiana	1	1	1
Tennessee	1	1	1
Other	5	6	6
	100%	100%	100%

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

During the third quarter, a series of five hurricanes caused significant 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 and 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 District portfolio remained relatively stable during the twelve months ended December 31, 2004. At year-end, the District's net loans were classified as follows:

	2004	2003	2002
Acceptable	94.50%	92.81%	92.18%
OAEM	3.32	4.76	5.22
Adverse	2.18	2.43	2.60
Total	100.00%	100.00%	100.00%

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

Delinquencies were 0.42 percent of total loan assets at year-end 2004 compared to 0.86 percent at year-end 2003. Nonperforming assets for the District represented 0.75 percent of total loan assets or $111 million as of December 31, 2004, and 0.86 percent or $123 million as of December 31, 2003. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

Net chargeoffs totaled $7.9 million and reflected a $5.3 million increase compared to the prior year-end. As a percentage of the $14.9 billion in total loan assets, the net chargeoff for the District was 0.05 percent.

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.

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

	Percent of Portfolio		
Commodity Group	**2004**	**2003**	**2002**
Poultry	12%	12%	12%
Forestry	12	10	10
Cattle	8	8	7
Grain	7	7	7
Dairy	7	7	7
Rural home	6	6	7
Nursery/Greenhouse	5	5	5
Swine	3	4	4
Tobacco	3	3	3
Cotton	3	3	3
Citrus	2	3	4
Utilities	2	3	3
Other	30	29	28
Total	100%	100%	100%

The table illustrates that in 2004 commodity concentrations were greater than 5 percent in only six segments. The concentration in these segments is mitigated by non-farm income of the borrowers as demonstrated in 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%

The District has 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 District 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 dispersed as production is segregated among chicken, turkey, and egg production. Dairy herds range in size from less than 100 cows to approximately 10,000. The District also manages its 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 District loan volume. 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. Much of the individual loan exposure above $5 million is subsequently sold to other Associations or AgFirst.

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 District's stable credit quality and solid financial performance over time.

AgFirst and each Association maintain an allowance for loan losses determined by its management and is capitalized to serve its unique market. 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%	0.61%
Low	12.23%	8.39%	0.08%

Accounting Developments Related to the Allowance for Loan Losses

During 2004, the Bank and affiliated Associations completed studies to further refine their allowance for loan losses methodologies 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 these studies and the resulting refinements in methodologies, during the fourth quarter of 2004 the Bank and Associations recorded in aggregate, a $215,425 reversal of the allowance for loan losses.

The Bank and Associations allowance for loan losses methodologies were 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 and Associations allowance for loan losses methodologies utilized throughout the period were in accordance with generally accepted accounting principles and were consistently applied.

While conservative in estimating the allowance for loan losses, the methodologies 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 and Associations allowance for loan losses methodologies have 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 methodologies resulted in calculated allowances 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 and Associations 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 reversals 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 District. "Risk funds" (capital plus the allowance for loan losses), totaled $3.095 billion at December 31, 2004 (20.8 percent of the District's loans), as compared with $2.878 billion at December 31, 2003 (20.08 percent of the District's 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	$ 316,735	$ 311,180	$ 301,615
Provision for loan losses	2,037	8,153	25,263
Nonrecurring provision for loan loss reversal	(215,425)	—	—
Loans charged off	(9,887)	(5,885)	(17,283)
Recoveries	1,959	3,287	1,585
Balance at end of year	$ 95,419	$ 316,735	$ 311,180
Allowance for loan losses to loans	0.64%	2.21%	2.25%
Allowance for loan losses to nonaccrual loans	93.78%	261.62%	273.80%
Allowance for loan losses to participation loans & SMMU loans	11.00%	29.86%	26.35%

Please refer to Note 3, *Refinement of the Allowance for Loan Loss Methodologies* and Note 5, *Loans and Allowance for Loan Losses* in the Notes to the Combined Financial Statements for further information concerning the allowance for loan losses.

Results of Operations

Net Income

District net income totaled $535.2 million for the year ended December 31, 2004, an increase of $215.6 million over 2003, while 2003 net income increased $7.1 million over 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)	$ 319,631	$ 312,547
Increase (decrease) due to:		
Total interest income	41,189	(44,386)
Total interest expense	(48,276)	67,241
Net interest income	(7,087)	22,855
Provision for loan losses	221,541	17,110
Noninterest income	3,962	(8,119)
Noninterest expense	6,668	(28,087)
Provision for income taxes	(9,504)	3,325
Total increase (decrease) in net income	215,580	7,084
Net income	$ 535,211	$ 319,631

Interest Income

Total interest income for the year ended December 31, 2004 was $901,683, an increase of $41,189, as compared to the same period of 2003. Total interest income for 2003 was $860,494, a decrease of $44,386 over the same period of 2002. The increase from 2003 to 2004 is primarily attributed to increases 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	$ 1,064,691	$ 1,714,316
Average yield (prior year)	5.08%	5.94%
Interest income variance attributed to change in volume	54,064	101,845
Average earning assets (current year)	18,010,573	16,945,882
Increase (decrease) in average yield	(.07%)	(.86%)
Interest income variance attributed to change in yield	(12,875)	(146,231)
Net change in interest income	$ 41,189	$ (44,386)

Despite rising rates, the average yield on earning assets declined slightly, as growth in lower-yielding investment securities exceeded loan growth. Additionally, borrower refinancing activity continued into early 2004.

Interest Expense

Total interest expense for the year ended December 31, 2004 was $332,857, an increase of $48,276, as compared to the same period of 2003. Total interest expense for the year ended December 31, 2003 was $284,581, a decrease of $67,241 over the same period of 2002. The increase in interest expense from 2003 to 2004 is primarily attributed to rising interest rates, and an increase in interest-bearing liabilities to support asset growth. The decrease in interest expense from 2002 to 2003 was primarily attributable to falling interest rates, partially offset by the increase in interest-bearing liabilities.

Prior to the adoption of Statement of Financial Accounting Standard (SFAS) No. 150, *Accounting for Certain Financial Instruments with both Characteristics of Liabilities and Equity,* 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 prospectively reflected as interest expense. As a result, $9,443, 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 2003.

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	$ 1,014,555	$ 1,558,036
Average rate (prior year)	2.03%	2.82%
Interest expense variance attributed to change in average interest-bearing liabilities	20,594	43,988
Average interest-bearing liabilities (current year)	15,034,085	14,019,530
Increase (decrease) in average rate	.18%	(.79%)
Interest expense variance attributed to change in rate	27,682	(111,229)
Net change in interest expense	$ 48,276	$ (67,241)

Net Interest Income

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

Analysis of Net Interest Income

	2004 Avg. Balance	2004 Interest	2003 Avg. Balance	2003 Interest	2002 Avg. Balance	2002 Interest
Loans	$ 14,429,728	$ 827,111	$ 13,951,128	$ 801,068	$ 13,283,343	$ 842,022
Cash & investments	3,580,845	74,572	2,994,754	59,426	1,948,223	62,858
Total earning assets	$ 18,010,573	$ 901,683	$ 16,945,882	$ 860,494	$ 15,231,566	$ 904,880
Interest-bearing liabilities	$ 15,034,085	$ (332,857)	$ 14,019,530	$ (284,581)	$ 12,461,494	$ (351,822)
Impact of capital	$ 2,976,488		$ 2,926,352		$ 2,770,072	
Net interest income		$ 568,826		$ 575,913		$ 553,058

	2004 Average Yield	2003 Average Yield	2002 Average Yield
Yield on loans	5.73%	5.74%	6.34%
Yield on cash & investments	2.08%	1.98%	3.23%
Yield on earning assets	5.01%	5.08%	5.94%
Cost of interest-bearing liabilities	2.21%	2.03%	2.82%
spread	2.79%	3.05%	3.12%
Impact of capital	.37%	.35%	.51%
Net interest income/avg. earning assets	3.16%	3.40%	3.63%

The District's average spread declined by 26 basis points compared to 2003. Net interest income (and spread) in 2002 was positively impacted by the District'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."

From an Association owner's point-of-view, a decline in interest rates, and the resulting negative impact on net interest income, are not negative events. The funding structure described above essentially makes equity behave like a variable rate investment. When rates go up, the investment earns more. When rates go down, the investment earns less. However, when coupled with the Associations' patronage strategies, this structure can provide some degree of stability to the total shareholder/borrower relationship. Falling rates may depress earnings at the Association level (all other things being equal), which may result in a lower patronage level; however, at the same time, Association members enjoy a lower cost of borrowing.

Provision for Loan Losses

AgFirst and each Association assess risks inherent in their individual portfolios on an ongoing basis and establish an appropriate reserve for loan losses. As referenced above, the $215.4 million reversal in 2004 resulted from the District's studies, and the resulting refinements in methodologies completed during the fourth quarter of 2004. Provisions of $8,153 and $25,263 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 $53,703, an increase of $3,962, compared to 2003. The primary reason for this increase was 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, offset by the decrease of $2,009 in loan fees.

For the year ended December 31, 2003, total noninterest income decreased $8,119 compared to 2002. In 2003, there was a decrease of $13,778 in gains on the sale of rural home loans compared to the prior year. In addition, no interest income was recorded in 2003 for IRS refunds, compared to $2,865 income for these refunds recorded in 2002. These decreases were offset by a $7,358 increase in loan fee income and an increase in realized gains on investments of $1,635 for 2003 compared to 2002.

Noninterest Expense

Noninterest expense for the year ended December 31, 2004 was $290,343, a decrease of $6,668 compared to the same period of 2003. Noninterest expense at December 31, 2003 was $297,011 compared to $268,924 in 2002. The following table illustrates the sources of variance.

	Year Ended December 31, 2004	2003
Prior year noninterest expense	$ 297,011	$ 268,924
Change in expense:		
Salaries and employee benefits	6,064	21,364
Occupancy and equipment	1,938	755
Insurance Fund Premium	(9,091)	12,132
Other operating expenses	4,864	(1,889)
Intra-System financial assistance expense	(6,368)	(2,319)
Restructuring charge	3,697	—
Called debt expense	(8,376)	(1,782)
Other noninterest expenses	604	(174)
Noninterest expense	$ 290,343	$ 297,011

Salaries and employee benefits have trended up over the two-year period. The increase from 2003 to 2004 was influenced by higher salaries expense 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.

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.

Intra-System financial assistance decreased $6,368 from 2003 to 2004. Intra-System financial assistance decreased $2,319 from 2002 to 2003. These decreases were due to the retirement of several Financial Assistance Corporation bonds. See Note 13, *Intra-System Financial Assistance,* in the Notes to the Combined Financial Statements for further information.

Restructuring charges of $3,697 were recorded for the twelve months ended December 31, 2004, compared to $0 the previous year. This expense resulted from nonrecurring costs related to an Association consolidation. Effective January 1, 2004, AgSouth Farm Credit, ACA merged with Palmetto Farm Credit, ACA. The merged Association is called AgSouth Farm Credit, ACA, and is headquartered in Statesboro, Georgia.

Other operating expenses increased $4,864 from 2003 to 2004 and decreased $1,889 from 2002 to 2003. The increase from 2003 to 2004 was primarily the result of professional fees paid for consultants' assistance related to the District compliance with new System disclosure and governance practices. The decrease in 2003 primarily resulted from a decrease in purchased services compared to the prior year. During 2002, the District incurred substantial purchased service expense related to a thorough review and revamping of its accounting processes in preparation of implementing new financial systems in the 2003 – 2004 timeframe.

Called debt expense decreased $8,376 in 2004 and decreased $1,782 in 2003. 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. Falling interest rates enabled AgFirst to call a substantial amount of debt during 2003, and 2002, resulting in called debt expense of $11,736 and $13,518, respectively. Stable-to-rising rates in 2004 significantly reduced call opportunities. The called debt was $2,532 million, $8,588 million, and $13,190 million for 2004, 2003, and 2002, respectively.

Provision for Income Taxes

Provision for income taxes increased $9,504 in 2004 compared to 2003. The increase is primarily attributable to the reversal of the allowance for loan losses. See Note 11, *Income Taxes*, in the Notes to the Combined Financial Statements for further details.

Liquidity and Funding Sources

AgFirst maintains adequate liquidity to satisfy the District's 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 the District totaled $3.7 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		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 whole loans	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 Combined Balance Sheet, excluding cash equivalents.*

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 the District 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,* in the Notes to the Combined Financial Statements 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.*

AgFirst provides each Association with core operating systems and support, including a loan origination system, loan accounting and servicing systems, general ledger, 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 following table sets forth the amounts of AgFirst's 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 18, *Derivative Instruments and Hedging Activities*, in the Notes to the Combined Financial Statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2004.

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, the District had contributed $106,592 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 12, *Employee Benefit Plans*, in the Notes to the Combined 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 and 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 plus accrued and unpaid dividends for then current dividend period to the date of redemption.

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 fifteenth 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, *Protected Borrower Equity and Shareholders' Equity,* in the Notes to the Combined Financial Statements of this annual report for more detailed information concerning the preferred stock issuances.

Capital

Total shareholders' equity at December 31, 2004 was $2,999,645 compared to $2,561,731 and $2,280,556 at December 31, 2003 and 2002, respectively. The increases in shareholders' equity are attributed to the issuance of perpetual preferred stock in 2003 and increases in retained earnings.

Capital adequacy is evaluated using a number of regulatory ratios. For all periods presented, AgFirst and the Associations exceeded all minimum regulatory standards. Improvement in the AgFirst Bank-only permanent capital, total surplus, and core surplus ratios from December 31, 2002 to December 31, 2003 was primarily attributed to the accumulation of earnings, offset somewhat by asset growth.

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 standard regulatory minimum of 103 percent. At December 31, AgFirst's regulatory ratios were:

	Regulatory Minimum	AgFirst Ratio as of 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 improvement in the permanent capital, total surplus and core surplus ratios from December 31, 2003 to December 31, 2004 was primarily due to the accumulation of earnings, offset somewhat by asset growth.

Additionally, the significant improvement in the permanent capital, total surplus and net collateral ratios from December 31, 2002 to December 31, 2003 was primarily due to the issuance of $150 million of perpetual preferred stock. The stock had no impact on the core surplus ratio, as preferred stock is not considered to be "core surplus."

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, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Combined 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 and 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 programs 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 tables 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 and Beginning 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 ranchers	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 16, *Commitments and Contingencies*, in the Notes to the Combined Financial Statements for additional information.

Actions are pending against AgFirst and certain District Associations 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 combined financial position of AgFirst and the District Associations.

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 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.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the combined 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 16 to the combined 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 combined financial statements, *Protected Borrower Equity and 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 16 to the combined 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 a 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 *Ag***Choice** 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 *Ag***Choice** 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.

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 Group, 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 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 Bd. 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 14 to the combined 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.

Combined Financial Statements

The combined financial statements, together with the report thereon of PricewaterhouseCoopers LLP, dated March 7, 2005, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Borrower Information Regulations

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

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

Shareholder Investment

Shareholder investment in a District Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's 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. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's Web site 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 7, 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 7, 2005

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

In our opinion, the accompanying combined balance sheets and the related combined 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 District Associations 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 District'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

Combined Balance Sheets

(dollars in thousands)	December 31, 2004	December 31, 2003	December 31, 2002
Assets			
Cash and cash equivalents	$ 522,862	$ 527,250	$ 444,457
Investment securities, available for sale	3,278,414	2,832,716	2,153,118
Loans	14,848,831	14,336,779	13,823,089
Less: allowance for loan losses	95,419	316,735	311,180
Net loans	14,753,412	14,020,044	13,511,909
Accrued interest receivable	131,402	122,007	131,638
Investments in other Farm Credit System institutions	8,229	19,157	18,736
Premises and equipment, net	96,603	86,914	77,361
Other property owned	3,433	2,253	4,828
Deferred tax assets, net	2,229	13,303	13,761
Other assets	198,832	72,273	71,193
Total assets	$18,995,416	$17,695,917	$16,427,001
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	52,025	43,733
Dividends and patronage refunds payable	81,607	68,885	64,180
Postretirement benefits other than pensions	92,970	79,249	67,193
Minimum pension liability	—	52,519	61,822
Other liabilities	127,955	149,403	145,142
Total liabilities	15,995,771	15,134,186	13,920,606
Commitments and contingencies (Note 16)			
Mandatorily redeemable preferred stock (Note 9)	—	—	225,839
Shareholders' Equity			
Perpetual preferred stock (Note 10)	150,000	150,000	—
Protected borrower equity	10,123	12,453	15,486
Capital stock and participation certificates	125,089	128,099	124,541
Retained earnings			
Allocated	849,626	792,168	756,525
Unallocated	1,861,476	1,587,934	1,494,659
Accumulated other comprehensive income (loss)	3,331	(108,923)	(110,655)
Total shareholders' equity	2,999,645	2,561,731	2,280,556
Total liabilities and shareholders' equity	$18,995,416	$17,695,917	$16,427,001

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

Combined Statements of Income

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Interest Income			
Investment securities and other	$ 74,572	$ 59,426	$ 62,858
Loans	827,111	801,068	842,022
Total interest income	901,683	860,494	904,880
Interest Expense	332,857	284,581	351,822
Net interest income	568,826	575,913	553,058
Provision for (reversal of) loan losses	(213,388)	8,153	25,263
Net interest income after provision for loan losses	782,214	567,760	527,795
Noninterest Income			
Loan fees	34,317	36,326	31,568
Fees for financially related services	6,544	6,249	5,077
Realized gains (losses) on investments, net	3,345	247	(1,388)
Gains (losses) on sale of rural home loans	(717)	523	14,301
Other noninterest income	10,214	6,396	8,302
Total noninterest income	53,703	49,741	57,860
Noninterest Expenses			
Salaries and employee benefits	179,907	173,843	152,479
Occupancy and equipment	26,441	24,503	23,748
Insurance Fund premium	7,088	16,179	4,047
Other operating expenses	60,895	56,031	57,920
Intra-System financial assistance expenses	6,794	13,162	15,481
Restructuring charge	3,697	—	—
Called debt expense	3,360	11,736	13,518
Other noninterest expenses	2,161	1,557	1,731
Total noninterest expenses	290,343	297,011	268,924
Income before income taxes	545,574	320,490	316,731
Provision for income taxes (Note 11)	10,363	859	4,184
Net income	$ 535,211	$ 319,631	$ 312,547

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

Combined Statements of Changes in Shareholders' Equity

(dollars in thousands)	Perpetual Preferred Stock	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2001	$ —	$ 19,261	$ 127,271	$ 733,378	$ 1,393,592	$ 7,041	$ 2,280,543
Comprehensive income							
Net income					312,547		312,547
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						(107,770)	(107,770)
Total comprehensive income							194,851
Protected borrower equity retired		(3,775)					(3,775)
Capital stock/participation certificates issued/retired, net			(2,820)				(2,820)
Dividends declared/paid			90		(1,971)		(1,881)
Mandatorily redeemable preferred stock dividends accrued					(18,887)		(18,887)
Patronage distribution							
Cash					(62,965)		(62,965)
Qualified allocated surplus				50,936	(50,936)		—
Nonqualified allocated surplus				42,261	(42,261)		—
Nonqualified retained surplus				32,402	(32,402)		—
Retained earnings retired				(105,217)			(105,217)
Patronage distribution adjustment				2,765	(2,058)		707
Balance at December 31, 2002	—	15,486	124,541	756,525	1,494,659	(110,655)	2,280,556
Comprehensive income							
Net income					319,631		319,631
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						9,096	9,096
Total comprehensive income							321,363
Perpetual preferred stock issued	150,000						150,000
Protected borrower equity retired		(3,033)					(3,033)
Capital stock/participation certificates issued/retired, net			3,474				3,474
Dividends declared/paid			84		(2,242)		(2,158)
Perpetual preferred stock dividends paid					(1,851)		(1,851)
Mandatorily redeemable preferred stock dividends accrued					(9,443)		(9,443)
Patronage distribution							
Cash					(65,634)		(65,634)
Qualified allocated surplus				46,636	(46,636)		—
Nonqualified allocated surplus				47,154	(47,154)		—
Nonqualified retained surplus				48,391	(48,391)		—
Retained earnings retired				(111,175)			(111,175)
Patronage distribution adjustment				4,637	(5,005)		(368)
Balance at December 31, 2003	150,000	12,453	128,099	792,168	1,587,934	(108,923)	2,561,731
Comprehensive income							
Net income					535,211		535,211
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						98,275	98,275
Total comprehensive income							647,465
Protected borrower equity retired		(2,330)					(2,330)
Capital stock/participation certificates issued/retired, net			(3,070)				(3,070)
Dividends declared/paid			60		(3,840)		(3,780)
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(76,686)		(76,686)
Qualified allocated surplus				28,684	(28,684)		—
Nonqualified allocated surplus				65,666	(65,666)		—
Nonqualified retained surplus				74,467	(74,467)		—
Retained earnings retired				(111,010)			(111,010)
Patronage distribution adjustment				(349)	(1,376)		(1,725)
Balance at December 31, 2004	$ 150,000	$ 10,123	$ 125,089	$ 849,626	$ 1,861,476	$ 3,331	$ 2,999,645

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

Combined Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Cash flows from operating activities:			
Net income	$ 535,211	$ 319,631	$ 312,547
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	13,997	12,624	11,875
Provision for (reversal of) loan losses	(213,388)	8,153	25,263
(Gains) losses on other property owned, net	479	193	(377)
Realized (gains) losses on investments, net	(3,345)	(247)	1,388
Realized (gains) losses on mortgage loans held for sale	717	(523)	(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	(9,395)	9,631	12,047
(Increase) decrease in investments in other Farm Credit System institutions	10,928	(421)	860
(Increase) decrease in deferred tax assets, net	11,074	458	7,471
(Increase) decrease in other assets	(126,559)	1,302	45,818
Increase (decrease) in accrued interest and dividend payable	13,829	8,292	(16,710)
Increase (decrease) in postretirement benefits other than pensions	13,721	12,056	6,878
Increase (decrease) in minimum pension liability	(52,519)	(9,303)	61,822
Increase (decrease) in other liabilities	63,688	13,884	(121,729)
Total adjustments	(348,630)	143,389	294,801
Net cash provided by (used in) operating activities	186,581	463,020	607,348
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	(453,354)	(609,583)	(1,222,635)
Purchase of premises and equipment, net	(23,686)	(22,177)	(14,130)
Proceeds from sale of other property owned	2,855	6,966	2,928
Net cash used in investing activities	(914,679)	(1,313,625)	(1,718,164)
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	—
Protected borrower equity retired	(2,330)	(3,033)	(3,775)
Capital stock and participation certificates issued/retired, net	(3,070)	3,474	(2,820)
Patronage refunds and dividends paid	(66,435)	(64,420)	(59,614)
Dividends paid on perpetual preferred stock	(10,950)	(1,851)	—
Dividends paid on mandatorily redeemable preferred stock	—	(10,282)	(18,887)
Retained earnings retired	(111,010)	(111,175)	(105,217)
Net cash provided by financing activities	723,710	933,398	1,215,732
Net increase (decrease) in cash and cash equivalents	(4,388)	82,793	104,916
Cash and cash equivalents, beginning of period	527,250	444,457	339,541
Cash and cash equivalents, end of period	$ 522,862	$ 527,250	$ 444,457
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 627	$ 671	$ 3,553
Loans transferred to other property owned	5,141	4,817	5,095
Patronage refund and dividends payable	81,607	68,885	64,180
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	98,275	9,096	(107,770)
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	$ 319,028	$ 276,289	$ 368,532
Taxes paid, net	1,772	2,716	4,652
Federal tax refunds related to settlement on long-term lending operations (Note 11)	816	901	5,834

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

Notes to Combined Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** AgFirst Farm Credit Bank (AgFirst or the Bank) 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. AgFirst 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 (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. All District Associations borrow funds from the Bank. 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 AgFirst and District Associations. The activities of AgFirst and District 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 District average loan principal outstanding until the assets 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 AgFirst and the District Associations.

AgFirst and/or the District Associations are authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. AgFirst may also lend to financial institutions engaged in lending to eligible borrowers. The District Associations may also serve as an intermediary in offering credit life insurance and multi-peril crop insurance, and in providing additional services to borrowers.

The District Associations borrow from AgFirst and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members. As noted above, as of January 1, 2005, all Associations have reorganized into parent-subsidiary structures and operate their long-term mortgage activities through FLCA subsidiaries and their short- and intermediate-term lending activities through PCA subsidiaries or the ACA.

AgFirst owns the Farm Credit Finance Corporation of Puerto Rico (the Finance Corporation). The Finance Corporation currently borrows funds from AgFirst 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.

AgFirst, 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, as required by the Farm Credit Act.
- *Farm Credit System Association Captive Insurance Company* — a reciprocal insurer that provides insurance services to its member organizations.

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 District conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of combined financial statements in conformity with GAAP requires the managements of AgFirst and District Associations to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates. Certain amounts in prior years' financial statements have been reclassified to conform to the current year's financial statement presentation.

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

A. **Cash and Cash Equivalents:** Cash, as included in the financial statements of cash flow, represents cash on hand and deposits at banks.

B. **Investment Securities:** The District, 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 District'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 Combined Balance Sheets. 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 District 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 original maturities ranging up to forty years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of ten 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 (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 inherent 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 the 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 methodologies.

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

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

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

E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is generally 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 operating results. Maintenance and repairs are charged to operating expense and improvements are capitalized.

F. **Other Assets and Other Liabilities:** Direct expenses incurred in issuing debt 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 on the balance sheet, at fair value, as either other assets or other liabilities.

G. **Advanced Conditional Payments:** The District Associations are authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, those advanced conditional payments (ACPs) are netted against the borrower's related loan balance. ACPs which are held by the District but cannot be used to reduce outstanding loans balances, except at the direction of the borrower, are classified as other liabilities in the combined balance sheets. ACPs are not insured, and interest is generally paid by the associations on such balances. The total outstanding gross balances of advance conditional payments, both netted against loans and classified as other liabilities at December 31, 2004, 2003 and 2002 were $179 million, $154 million and $153 million, respectively.

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

District employees are eligible to participate in the thrift/deferred compensation plan (Thrift Plan), which qualifies as a 401(k) plan as defined by Internal Revenue Code. The Thrift Plan requires AgFirst and Associations to match a percentage up to a maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

In addition to providing pension benefits, the Bank and District Association provides certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all employees may become eligible for these benefits it they reach early retirement age while working for the Bank or District Association.

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

I. **Income Taxes:** AgFirst and FLCA subsidiaries of ACA parent companies are exempt from Federal and other income taxes as provided in the Farm Credit Act. Puerto Rico Farm Credit, ACA receives 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*. In addition, an ACA may reorganize and create taxable PCA and non-taxable FLCA subsidiaries.

Twenty-one of the twenty-three District Associations had formed tax-exempt FLCA subsidiaries as of December 31, 2004 as described in Note 1(A) — *Organization.* The other two formed such subsidiaries effective January 1, 2005.

The ACAs provide for Federal and certain other income taxes and are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Most District Associations operate as cooperatives under Subchapter T and can deduct from taxable income, amounts distributed as qualified patronage refunds to borrowers in the form of cash, stock or allocated retained earnings. Amounts distributed as nonqualified patronage refunds are tax deductible by the ACAs only when redeemed. Income taxes are provided only on the earnings not distributed or not expected to be distributed as qualified patronage refunds or those earnings that are exempt from tax due to the long-term lending exemption.

District Associations recognize deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. District Associations may provide a valuation allowance for deferred tax assets to the extent that it is more likely than not that they will not be realized.

At December 31, 2004, deferred income taxes have not been provided by certain District Associations on approximately $127 million of patronage refunds received prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. Under GAAP, deferred taxes must be provided on all patronage refunds made to taxable District Associations after December 31, 1992, except to the extent that a portion of these amounts will be distributed in the form of patronage to District Association members.

No deferred taxes have been provided on AgFirst's unallocated earnings. AgFirst currently has no plans to distribute unallocated AgFirst earnings and does not contemplate circumstances, which, if distributions were made, would result in taxes being paid at the Association level.

J. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. Derivatives are recorded on the 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 derivate 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.

K. **Valuation Methodologies:** Management of the District applies various valuation methodologies 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 District's results of operations.

L. **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 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 other 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, *Mandatorily Redeemable Preferred Stock*, 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 District. The District adopted the provisions of SOP 03-3 effective January 1, 2005, and the initial implementation did not have a significant effect on the District's combined financial position or combined results of operations.

In March 2004, the SEC Staff issued Staff Accounting Bulletin No. 105, *Application of Accounting Principles to Loan Commitments* (SAB 105). SAB 105 clarifies existing accounting practices relating to the valuation of issued loan commitments, including interest rate lock commitments (IRLC), subject to SFAS No. 149 and Derivative Implementation Group Issue C13, *Scope Exceptions: When a Loan Commitment is included in the Scope of Statement 133*. Furthermore, SAB 105 disallows the inclusion of the values of a servicing component and other internally developed intangible assets in the initial and subsequent IRLC valuation. The provisions of SAB 105 affect only the timing of mortgage banking income recognition and were effective for loan commitments entered after March 31, 2004. The initial impact did not have a significant effect on the District's combined financial position or combined 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 12, *Employee Benefit Plan*s.

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 District 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 District has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the District 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 District's combined financial position or combined results of operations.

Note 3 — Refinement of the Allowance for Loan Losses Methodologies

During 2004, the District conducted studies to further refine the allowance for loan losses methodologies 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 District's allowance for loan losses methodologies were 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 District's allowance for loan losses methodologies utilized throughout the period were in accordance with generally accepted accounting principles and were consistently applied.

While conservative in estimating the allowance for loan losses, the methodologies 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 District's allowance for loan losses methodologies have consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator.

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 District completed its studies and refined its methodologies to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodologies 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 $215 million reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodologies 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 District, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $3,095 million at December 31, 2004 (20.8 percent of District loans), as compared with $2,878 million at December 31, 2003 (20.1 percent of District loans) and $2,281 million at December 31, 2002 (18.7 percent of District 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, is as 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 either 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 which 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 continuous loss position based on the date the impairment occurred. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. AgFirst 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

Note 5 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2004	2003	2002
Long-term farm mortgage	$ 6,768,081	$ 6,315,505	$ 5,813,020
Production and intermediate-term	5,631,519	5,412,454	5,365,864
Rural home	839,712	800,123	939,943
Farm-related business	223,187	201,181	178,773
Utility	266,015	401,535	403,169
Basic processing and marketing	281,862	268,113	235,822
Sales contracts/purchase money mortgage	84,488	41,118	15,103
Domestic loans to agricultural cooperatives	340,672	396,000	500,232
Other	413,295	500,750	371,163
Total	$ 14,848,831	$ 14,336,779	$ 13,823,089

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

Total loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	2004	2003	2002
Poultry	12%	12%	12%
Forestry	12	10	10
Cattle	8	8	7
Grain	7	7	7
Dairy	7	7	7
Rural home	6	6	7
Nursery/Greenhouse	5	5	5
Swine	3	4	4
Tobacco	3	3	3
Cotton	3	3	3
Citrus	2	3	4
Utilities	2	3	3
Other	30	29	28
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 impaired loans.

	December 31, 2004	2003	2002
Nonaccrual:			
Current as to principal and interest	$ 59,967	$ 42,448	$ 50,431
Past due	41,782	78,618	63,223
Accrual:			
Restructured	3,556	4,328	5,354
90 days or more past due	2,034	2,804	9,720
Total impaired loans	$ 107,339	$ 128,198	$ 128,728

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2004.

The following table presents interest income recognized on impaired loans.

	Year Ended December 31, 2004	2003	2002
Interest income recognized on nonaccrual loans	$ 9,826	$ 11,520	$ 9,927
Interest income on impaired accrual loans	1,543	1,434	1,874
Interest income recognized on impaired loans	$ 11,369	$ 12,954	$ 11,801

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

	2004	2003	2002
Impaired loans with related allowance	$ 39,597	$ 42,695	$ 19,613
Impaired loans with no related allowance	67,742	85,503	109,115
Total impaired loans	$ 107,339	$ 128,198	$ 128,728
Average impaired loans	$ 120,899	$ 131,837	$ 124,274
Allowance on impaired loans	$ 26,473	$ 20,667	$ 10,671

A summary of changes in the allowance for loan losses follows:

	Year Ended December 31,		
	2004	2003	2002
Balance at beginning of year	$ 316,735	$ 311,180	$ 301,615
Provision for (reversal of) loan losses	2,037	8,153	25,263
Reversal of provision due to change in methodology	(215,425)	—	—
Loans charged off	(9,887)	(5,885)	(17,283)
Recoveries	1,959	3,287	1,585
Balance at end of year	$ 95,419	$ 316,735	$ 311,180

To mitigate the risk of loans being placed in nonaccrual status, System institutions may enter into long-term-standby-commitment-to-purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Bank or Association the right to sell the loans identified in the agreements for "par" to Farmer Mac in the event a delinquency of four months occurs. The balance of loans under long-term standby commitments was $662 million, $564 million and $411 million at December 31, 2004, 2003 and 2002, respectively. Fees paid to Farmer Mac for such commitments totaled $2.6 million, $2.2 million and $1.6 million for the years ended December 31, 2004, 2003 and 2002, respectively. 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. These amounts are classified as noninterest expense.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2004	2003	2002
Land	$ 17,938	$ 12,715	$ 12,034
Buildings and improvements	70,483	70,464	67,017
Furniture and equipment	84,891	72,462	70,232
Work in progress	10,553	10,442	4,605
	183,865	166,083	153,888
Less: accumulated depreciation	87,262	79,169	76,527
Total	$ 96,603	$ 86,914	$ 77,361

Note 7 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31,		
	2004	2003	2002
Other assets:			
Prepaid pension costs	$ 133,774	$ 8,942	$ 9,800
Derivative assets	1,125	3,484	1,920
Unamortized debt issue costs	9,054	9,109	7,168
Deferred preferred stock costs	3,385	3,974	2,331
Intangible asset related to pension	—	1,728	1,980
Prepaid expenses	807	760	600
Receivables and other	50,687	44,276	47,394
Total	$ 198,832	$ 72,273	$ 71,193
Other liabilities:			
Accounts payable	$ 24,174	$ 23,361	$ 21,111
Derivative liabilities	11,728	3,188	6,295
Farm Credit System Ins. Corp. payable	7,057	16,171	4,047
Bank draft payable	38,574	54,059	64,861
Other	46,422	52,624	48,828
Total	$ 127,955	$ 149,403	$ 145,142

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 Web site 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.

The District'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

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	2004-2018
6,000	2006	2008
$ 6,562,000		

Callable debt may be called on the first call date and, any date 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 of 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 $1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable at the rate of 8.393 percent per annum of the $1 thousand per share par value. 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 together with accrued and unpaid dividends to the redemption date. Beginning in 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 — Protected Borrower Equity and Shareholders' Equity

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

A. **Protected Stock:** Protection of certain borrower equity is provided under the Farm Credit Act which requires AgFirst and District Associations to retire such capital at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If a Bank or an Association is unable to retire protected borrower stock at par value or stated value, amounts required to retire this stock would be obtained from the Insurance Fund.

B. **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 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, Participation Certificates and Retained Earnings:** In accordance with the Farm Credit Act, borrowers are generally required to invest in their respective associations as a condition of borrowing. The District Associations' capital stock requirements are generally the lesser of 2 percent of the amount of the loan or $1 thousand. Some District Associations have dollar maximums, which range from $1 thousand to $5 thousand. Loans designated for sale or sold into the Secondary Market have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation. Association capitalization plans presently establish stock requirements in accordance with the Farm Credit Act and their respective bylaws.

   The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment; the aggregate par value is added to the principal amount of the related loan obligation. AgFirst and the Association have a first lien on the stock or participation certificates owned by their respective borrowers. Retirement of such equities will generally be at the lower of par or book value and repayment of a loan cannot automatically result in retirement of the corresponding stock or participation certificates.

District Associations:

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

The District Associations had the following shares outstanding at December 31, 2004:

		Shares Outstanding	
Class	**Protected Status**	**Number**	**Aggregate Par Value**
A Common Nonvoting	Yes	142,800	$ 714
A Common Nonvoting	No	—	—
B Common Nonvoting	Yes	1,742,400	8,712
B Common Nonvoting	No	—	—
B Common Voting	No	—	—
C Common Voting	No	17,856,400	89,282
B Participation Certificates	Yes	139,600	698
C Participation Certificates	No	1,883,400	9,417
Participation Certificates	No	—	—
A Preferred	No	3,386,800	16,934
C Preferred	No	139,000	695
Total Association Capital Stock and Participation Certificates		25,290,400	$ 126,452

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the respective boards of directors (Boards) at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Boards are met.

Participation Certificates are nonvoting and may be issued as a condition for obtaining a loan to rural home borrowers, to persons or organizations furnishing farm-related services, to persons or organizations who are eligible to borrow or participate in loans, but who are not eligible to hold voting stock, and to persons or organizations eligible to borrow for the purpose of qualifying them for technical assistance, financially related services, and/or leasing services offered by the Association.

Preferred Stock may be issued to such persons or investors as may be permitted under a plan adopted by each Board. Retirement will be at the sole discretion of each Board provided that the minimum capital adequacy standards established by the Board are met. If retired, Preferred Stock will be retired at its book value, not to exceed its par value. Preferred Stock is nonvoting and generally has preference over common stock and participation certificates as to dividends, and priority in the event of liquidation of an Association.

Retained Earnings

The Associations maintain unallocated retained earnings accounts and allocated retained earnings accounts. The minimum aggregate amounts of these two accounts are determined by each Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of an Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board.

The Associations maintain allocated retained earnings accounts consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss by an Association for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Associations have a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, an Association, upon approval of its Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2004, combined allocated retained earnings consisted of $456,075 of qualified surplus, $200,006 of nonqualified allocated surplus and $193,545 of nonqualified retained surplus.

Dividends

An Association may declare dividends on its capital stock and participation certificates. Such dividends generally may be paid solely on Preferred Stock, or on all classes of stock and participation certificates.

Patronage Distributions

Prior to the beginning of any fiscal year, each Board, by adoption of a resolution, may obligate its Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions, if made by that Association, are based on the proportion of the borrower's interest to the amount of interest earned by that Association on its total loans unless another proportionate patronage basis is approved by the Board.

If an Association will meet its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated retained earnings account, or combinations of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board.

Amounts not distributed are retained as unallocated retained earnings.

Transfer

Equities may generally be transferred to persons or entities eligible to purchase or hold such equities under an Association's bylaws.

Impairment

Any net losses recorded by an Association shall first be applied against unallocated retained earnings. To the extent that such losses would exceed unallocated retained earnings, resulting in impairment of the Association's allocated retained earnings or capital stock, such losses would be applied pro rata to each share and/or unit outstanding, provided applications shall be made to allocated retained earnings by annual series, with the most recent allocations applied first.

Liquidation

In the event of the liquidation or dissolution of an Association, any assets of the Association remaining after payment or retirement of all liabilities may be distributed either to the holders of the outstanding stock and participation certificates or on a patronage basis, dependent upon the bylaws of the Association.

AgFirst:

Capital Stock and Allocated Retained Earnings — District Associations are required to invest in the capital stock of AgFirst. These intercompany balances and transactions are eliminated in combination. Additionally, AgFirst has issued and has outstanding $11,531 in Class D Common stock, which is a nonvoting class of stock with a $5.00 par value.

Other Equity — At the inception of each other financing institutions (OFI) loan, AgFirst requires OFIs to make cash purchases of participation certificates in AgFirst. AgFirst has a first lien on these equities for the repayment of any indebtedness to AgFirst. At December 31, 2004, AgFirst had $76 thousand of participation certificates outstanding to OFIs at a face value of $5.00 per share.

Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require AgFirst and District Associations 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 the FCA that, if undertaken, could have a direct material effect on AgFirst's or District Associations' financial statements. AgFirst and District Associations are 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 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 following table shows the ranges of capital standards for the entities within the District at December 31, 2004.

	Permanent Capital Ratio Ranges	Core Surplus Ratio Ranges	Total Surplus Ratio Ranges
AgFirst	26.86%	15.60%	26.76%
District Associations	12% – 24%	8% – 24%	10% – 24%

AgFirst's capital adequacy is also evaluated using a ratio of net collateral to total liabilities. 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, 2004, AgFirst's net collateral ratio was 106.88 percent.

Included in the above table as of December 31, 2004, are twenty-one Associations that have reorganized through the creation of FLCA and PCA subsidiaries. These subsidiaries and the ACA operate under a common board of directors and joint management. As a result, these District Associations are jointly obligated on each other's liabilities and are evaluated on a consolidated basis for capital adequacy and other regulatory purposes.

All District entities were in compliance with the required minimum capital standards at December 31, 2004.

A regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. AgFirst and District Associations have not been called upon to initiate any transfers and are not aware of any proposed action under this regulation.

Note 11 — Income Taxes

The provision (benefit) for income taxes follows for the year ended December 31:

	Year Ended December 31, 2004	2003	2002
Current:			
Federal	$ 116	$ 1,960	$ 225
State	527	248	(427)
ACA tax refunds	(1,159)	(901)	(5,834)
	(516)	1,307	(6,036)
Deferred:			
Federal	6,530	(230)	3,664
State	1,382	(218)	(379)
Write-off deferred tax assets	2,967	—	6,935
	10,879	(448)	10,220
Total provision (benefit) for income taxes	$ 10,363	$ 859	$ 4,184

In connection with the reversal of the allowance for loan losses due to the refinement of methodologies, $11,190 in tax provision was recognized in 2004. This tax provision was partially offset by other tax adjustments. Additionally, from 2000 through 2002, Associations signed settlement agreements with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities. This settlement agreement was modeled after one used by another System ACA to reach a settlement agreement with the IRS in August 2000. As a result of this settlement, the Associations recorded tax refunds of $816, $901 and $5,834 in 2004, 2003 and 2002, respectively, which is included as a component of the 2004, 2003 and 2002 current income tax provision.

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

	Year Ended December 31, 2004	2003	2002
Federal tax at statutory rate	$185,495	$ 109,038	$ 107,580
State tax, net	1,126	341	74
Tax-exempt FLCA earnings	(91,370)	(48,942)	(40,676)
Association patronage distributions	(43,364)	(33,353)	(35,223)
Nontaxable Bank income	(18,230)	(31,015)	(29,004)
Possessions credit (Puerto Rico)	(785)	(511)	(690)
ACA tax refunds	(1,489)	(901)	(5,834)
Write-off of deferred tax assets	2,967	—	6,935
Allowance for loan loss reversal	(26,154)	—	—
Other	2,167	6,202	1,022
Provision for income taxes	$ 10,363	$ 859	$ 4,184

Deferred tax assets and liabilities are comprised of the following at:

	December 31, 2004	2003	2002
Allowance for loan losses	$ 10,671	$ 21,971	$ 21,712
Annual leave	169	158	162
Nonaccrual loan interest	1,359	1,164	1,579
Postretirement benefits other than pensions	1,106	1,087	1,259
Financial assistance payable	—	—	198
Nonqualified patronage distributions	29,987	15,875	13,897
Other	4,310	5,344	1,738
Gross deferred tax asset	47,602	45,599	40,545
Deferred tax asset valuation allowance	(21,350)	(18,142)	(15,577)
Future Bank stock redemptions	(2,787)	(4,684)	(3,442)
Bank patronage	(4,315)	(2,909)	(4,284)
State income tax	(653)	(1,087)	(802)
Loan fees	(1,444)	(1,694)	(1,602)
Pensions	(1,090)	(995)	(939)
Depreciation	(134)	(101)	(104)
Other	(13,600)	(2,684)	(34)
Gross deferred tax liability	(24,023)	(14,154)	(11,207)
Net deferred tax asset	$ 2,229	$ 13,303	$ 13,761

At December 31, 2004, deferred income taxes have not been provided by District Associations on approximately $127 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

Note 12 — Employee Benefit Plans

The employees of the District participate in one of three defined benefit retirement plans. The first plan (the District Plan) covers employees of eighteen Associations and AgFirst. The second plan covers employees of four ACAs, and the third plan covers employees of a single ACA. Each plan is noncontributory and covers substantially all employees of the participating entities.

The "Projected Unit Credit" actuarial method is used for financial reporting purposes and for funding purposes. Based on the funded status of the defined benefit retirement plans at the measurement date (September 30) of the underlying Plan, the District may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant.

The following table set forth the obligations and funded status of the retirement plans:

	PENSION BENEFITS		
	As of December 31,		
	2004	2003	2002
Change in benefit obligation			
Benefit obligation at beginning of year	$ 372,158	$ 324,397	$ 281,348
Service cost	13,937	11,159	9,324
Interest cost	22,888	21,268	20,619
Actuarial loss (gain)	43,502	30,744	33,809
Benefits paid	(16,753)	(14,973)	(18,510)
Other	7,155	(437)	(2,193)
Benefit obligation at end of year	$ 442,887	$ 372,158	$ 324,397
Change in plan assets			
Fair value of plan assets at beginning of year	$ 258,673	$ 214,702	$ 236,444
Actual return on plan assets	33,212	41,407	(15,471)
Employer contributions	106,618	17,537	12,239
Transfers	(173)	—	—
Benefits and premiums paid	(16,753)	(14,973)	(18,510)
Fair value of plan assets at end of year	$ 381,577	$ 258,673	$ 214,702
Funded Status	$ (61,310)	$(113,485)	$(109,695)
Unrecognized net actuarial loss (gain)	186,610	167,951	167,145
Unamortized prior service cost	3,946	3,722	1,980
Unrecognized net (asset) or obligation	(917)	(1,364)	(1,702)
Net amount recognized	$ 128,329	$ 56,824	$ 57,728
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ 133,774	$ 8,942	$ 9,800
Accrued benefit liability	(5,843)	(52,519)	(61,822)
Intangible asset	—	1,728	1,980
Accumulated other comprehensive income	398	98,673	107,770
Net amount recognized	$ 128,329	$ 56,824	$ 57,728
Components of net periodic benefit cost			
Service cost	$ 13,937	$ 11,159	$ 9,263
Interest cost	22,888	21,268	20,504
Expected return on plan assets	(23,278)	(18,857)	(21,548)
Amortization of net (gain) loss	(338)	(338)	(341)
Amortization of prior service cost	839	648	648
Recognized net actuarial (gain) loss	9,190	9,558	5,086
Other	(29)	—	—
Net periodic benefit cost	$ 23,209	$ 23,438	$ 13,612
Additional accruals	$ 315		
FAS 88 – special termination benefits	$ 1,552		

The following table summarizes the District sponsored pension plans that have projected benefit obligations in excess of plan assets and the accumulated benefit obligation of the unfunded executive supplemental retirement plans in which the accumulated benefit obligation exceeds plan assets. The liability for the supplemental retirement plans for highly compensated employees is included in other liabilities on the combined balance sheets. During 2004, the District entities funded $106,592 into the pension plans, eliminating the minimum pension liability. The District had prepaid pension costs of $133,774 included in other assets on the combined balance sheets as of December 31, 2004.

	As of December 31,		
	2004	2003	2002
Aggregate PBO > FV plan assets			
Projected benefit obligation	$ 442,887	$ 372,158	$ 323,749
Fair value of plan assets	381,577	258,673	214,703
Aggregate ABO > FV plan assets			
Accumulated benefit obligation	$ 5,729	$ 271,507	$ 241,914
Fair value of plan assets	—	218,989	180,092
Additional Information			
Increase/decrease in minimum liability included in other comprehensive income	$ 98,313	$ (9,379)	$ 61,822
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	6.00%	6.25%	6.75%
Rate of compensation increase	4.47%	4.46%	4.00%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.25%	6.25%	6.75%
Expected return on plan assets	8.92%	8.88%	8.87%
Rate of compensation increase	4.54%	4.46%	4.00%

Plan assets are invested using active investment strategies utilizing multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches are combined in a way that controls for capitalization, and style biases (equities), and interest rate anticipation strategies (fixed income) vs. benchmark indices while focusing primarily on issue selection as a means to add value. Risk is controlled through diversification among multiple asset classes, managers, styles, and securities. Risk is further controlled both at the manager and asset class level by assigning excess return and tracking error targets. Monitoring activities take place to evaluate performance against these targets. The target asset allocation is 45 percent U.S. equity, 20 percent non-U.S. equity, 5 percent real estate, and 30 percent fixed income.

Allowable investment types include:

U.S. Equity: Common stocks of large, medium, and small companies, which are predominantly U.S. based.

Non-U.S. Equity: Equity securities issued by companies domiciled outside the U.S. and in depository receipts, which represent ownership of securities of non-U.S. companies.

Fixed Income: Fixed income securities issued or guaranteed by the U.S. government, and to a lesser extent by non-U.S. governments, or by their respective agencies and instrumentalities, mortgage backed securities, including collateralized mortgage obligations, corporate debt obligations and dollar-denominated obligations issued in the U.S. by non-U.S. banks and corporations (Yankee bonds).

Real Estate: The real estate portfolio participates in private market investments representing a diversified portfolio of high-quality, operating and substantially leased properties.

The strategic role of real estate is to:

- Provide diversification relative to stocks and bonds, thereby lowering the overall return volatility of the entire Plan.
- Provide a long-term return between those of stocks and bonds.

PLAN ASSETS	2004	2003	2002
Asset Category			
Equity securities	67.1%	70.2%	67.3%
Debt securities	28.3	29.1	31.7
Real Estate	3.9	—	—
Other	.7	.7	1.0
	100.0%	100.0%	100.0%

Target allocation for asset categories for 2005 are as follows:

Asset Category	
Equity securities	65.0%
Debt securities	30.4
Real Estate	4.6
	100.0%

Projected benefit payouts are as follows:

2005	$ 18,112
2006	19,650
2007	20,813
2008	22,517
2009	24,705
2010-2014	158,020

The overall expected long-term rate of return on assets assumption is based on the target asset allocation for Plan assets, capital markets forecasts for asset classes employed, and active management excess return expectations. The total return for bonds is based on an equilibrium yield assumed to be 6 percent for government bonds plus an additional 0.5 percent due to the exposure of corporate debt in an aggregate benchmark, for a total return of 6.5 percent. A 3 percent equity premium is added to arrive at the forecast for equity returns, both foreign and domestic. Equilibrium forecasts are used to reflect long-term expectations for the asset classes employed. To the extent asset classes are actively managed, an excess return premium is added.

The District also sponsors supplemental retirement and deferred compensation plans for highly compensated employees. The plans are nonqualified; therefore, the associated liabilities are included in the District's combined balance sheets in other liabilities. The expenses of these plans included in the District's retirement costs were $956, $219 and $286 for the years ended December 31, 2004, 2003 and 2002, respectively.

The District also participates in a Districtwide defined contribution 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 and Associations will contribute $.50 for each $1.00 of the employee's contribution up to the maximum employer contribution of 3 percent of total compensation. For employees hired on or after January 1, 2003, the Bank and Associations will contribute $1.00 of the employee's 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. Employer contributions were $3,910, $3,601 and $3,318 for 2004, 2003 and 2002, respectively.

In addition to providing pension benefits, the Bank and District Association 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 or District Association.

The following is a table of other postretirement benefits expenses:

	OTHER POSTRETIREMENT BENEFITS		
	As of December 31,		
	2004	2003	2002
Change in benefit obligation			
Benefit obligation at beginning of year	$ 150,152	$ 137,442	$ 97,841
Service cost	3,719	3,633	2,695
Interest cost	9,272	9,089	7,180
Plan participant contributions	767		
Actuarial loss (gain)	(12,505)	5,637	35,142
Benefits paid	(5,329)	(5,419)	(5,416)
Plan amendments/other	(173)	—	—
Benefit obligation at end of year	$ 145,903	$ 150,382	$ 137,442
Change in plan assets			
Fair value of plan assets at beginning of year	$ —	$ 194	$ 207
Actual return on plan assets	—	—	17
Plan participant contributions	767	—	—
Employer contributions	4,562	5,225	5,386
Benefits and premiums paid	(5,329)	(5,419)	(5,416)
Fair value of plan assets at end of year	$ —	$ —	$ 194
Funded Status	$ (145,903)	$ (150,382)	$ (137,248)
Unrecognized net actuarial loss (gain)	40,028	56,172	52,042
Unrecognized prior service cost	(1,932)	(1,629)	(387)
Unrecognized net (asset) or obligation	14,837	16,590	18,400
Net amount recognized	$ (92,970)	$ (79,249)	$ (67,193)
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ —	$ —	$ —
Accrued benefit liability	(92,970)	(79,249)	(67,193)
Intangible asset	—	—	—
Accumulated other comprehensive	—	—	—
Net amount recognized	$ (92,970)	$ (79,249)	$ (67,193)
Components of net periodic postretirement benefit costs			
Service cost	$ 3,719	$ 3,633	$ 2,695
Interest cost	9,272	9,089	7,180
Expected return on plan assets	—	(5)	(12)
Amortization of net (gain) loss	1,786	1,790	1,791
Amortization of prior service cost	(184)	(93)	(60)
Recognized net actuarial (gain) loss	3,353	2,965	699
Net periodic benefit (income) cost	$ 17,946	$ 17,379	$ 12,293
EXPECTED FUTURE CASH FLOWS			
Expected contributions			
Fiscal 2005	$ 6,105		
Expected benefit payments (net of employee contributions)			
Fiscal 2005	$ 6,105		
Fiscal 2006	7,077		
Fiscal 2007	7,212		
Fiscal 2008	7,775		
Fiscal 2009	8,364		
Fiscal 2010-2014	48,792		
Expected Medicare Part D reimbursements			
Fiscal 2005	$ —		
Fiscal 2006	420		
Fiscal 2007	469		
Fiscal 2008	520		
Fiscal 2009	571		
Fiscal 2010-2014	3,532		
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	6.00%	6.25%	6.75%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.25%	6.75%	7.50%
Expected return on plan assets	N/A	N/A	8.00%

	As of December 31, 2004	2003	2002
Assumed health care cost trend rates:			
Health care cost trend rate assumed for next year	9.75%	10%–12%	10%–12%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2012	2013	2011

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

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost	$ 2,585	$ (2,056)
Effect on postretirement benefit obligation	21,851	(17,830)

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.

Note 13 — 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.

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 AgFirst 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 financial statements of AgFirst'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 reduced the effect of the unrecorded liability. Management considers the current and future effect of not recording the liability to be immaterial to AgFirst's financial condition and results of operations.

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

Note 14 — Related Party Transactions

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

Total loans to such persons at December 31, 2004, amounted to $235,331. During 2004, $230,057 of new loans were made and repayments totaled $220,919. In the opinion of management, no material amounts outstanding at December 31, 2004, involved more than a normal risk of collectibility.

Note 15 — Regulatory Enforcement Matters

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

Note 16 — Commitments and Contingencies

The District has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to combined financial statements. While primarily liable for its portion of bonds and notes, AgFirst 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 and Associations may participate in credit related financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers. 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 and District Associations to guarantee the performance of a customer to a third party. As of December 31, 2004, the Bank had $71.4 million in letters of credit with 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. As of December 31, 2004, the District Associations had $59.7 million in letters of credit with terms predominantly of one to three years. The notional amounts of these guarantees represent the maximum amount of exposure the Bank and the District Associations have related to these instruments as of December 31, 2004.

At December 31, 2004, $3.3 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 Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

Actions are pending against AgFirst and certain District Associations 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 combined financial position of AgFirst and District Associations.

Note 17 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the District'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.

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

	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	$ 14,848,831	$ 15,143,391	$ 14,369,690	$ 14,672,307	$ 13,823,089	$ 14,184,579
Allowance for loan losses	(95,419)	—	(316,735)	—	(311,180)	—
Loans, net	$ 14,753,412	$ 15,143,391	$ 14,052,955	$ 14,672,307	$ 13,511,909	$ 14,184,579
Derivative assets	$ 1,125	$ 1,125	$ 3,484	$ 3,484	$ 1,920	$ 1,920
Cash & investment securities	$ 3,801,276	$ 3,801,276	$ 3,327,055	$ 3,327,055	$ 2,597,575	$ 2,597,575
Financial liabilities:						
Systemwide Debt Securities	$ 15,402,385	$ 15,206,435	$ 14,507,105	$ 14,475,670	$ 13,538,536	$ 13,584,445
Financial assistance related liabilities*	$ (1,322)	$ (609)	$ 78	$ 2,660	$ 8,795	$ 12,095
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 District's financial instruments for which it is practicable to estimate that value follows:

A. **Loans:** Because no active market exists for the District's loans, fair value is estimated by discounting the expected future cash flows using the District'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 District's loan rates as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

   For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool. Fair value of loans in a nonaccrual status 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 yield spread relationship between Systemwide bonds and notes and comparable Treasury notes.

E. **Financial Assistance Related Liabilities:** As discussed in Note 13, 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 18 — Derivative Instruments and Hedging Activities

The District 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 District'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 District'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 District's gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The District 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.

The District 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 District to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the District if floating rate borrowings were made directly. Under interest rate swap arrangements, the District 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 District 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 their floating-rate assets. There are no floors outstanding currently.

By using derivative instruments, the District exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the District'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 District, thus creating a repayment risk for the District. When the fair value of the derivative contract is negative, the District owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the District deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. Transactions with seven counterparties represent approximately 0.25 percent of the total notional amount of interest rate swaps. The District does not anticipate nonperformance by any of these counterparties. The District typically enters into master agreements that contain netting provisions. These provisions allow the District 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 District had not posted collateral with respect to these arrangements.

The District's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the Committee's oversight of the District's asset/liability and treasury functions. The District'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 District's overall interest rate risk-management strategies.

Note 19 — Additional Derivative Financial Instruments and Other Financial Instruments Disclosure

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.

December 31, 2004 *(dollars in millions)*	Maturities of 2004 Derivative Products and Other Financial Instruments							
	2005	**2006**	**2007**	**2008**	**2009**	**After 2010**	**Total**	**Fair Value**
Systemwide Debt Securities:								
Fixed rate	$ 3,634	$ 2,078	$ 1,287	$ 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 20 — 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	$ 139,553	$ 141,788	$ 144,117	$ 143,368	$ 568,826
Provision for (reversal of) loan losses	150	112	1,775	(215,425)	(213,388)
Noninterest income (expense), net	(54,500)	(60,117)	(55,143)	(66,880)	(236,640)
(Provision) benefit for income taxes	(337)	(79)	1,607	(11,554)	(10,363)
Net income	$ 84,566	$ 81,480	$ 88,806	$ 280,359	$ 535,211

	2003				
	First	Second	Third	Fourth	Total
Net interest income	$ 143,582	$ 148,859	$ 142,074	$ 141,398	$ 575,913
Provision for loan losses	5,456	3,628	(281)	(650)	8,153
Noninterest income (expense), net	(55,340)	(62,721)	(63,489)	(65,720)	(247,270)
(Provision) benefit for income taxes	(313)	371	(17)	(900)	(859)
Net income	$ 82,473	$ 82,881	$ 78,849	$ 75,428	$ 319,631

	2002				
	First	Second	Third	Fourth	Total
Net interest income	$ 130,491	$ 134,409	$ 139,735	$ 148,423	$ 553,058
Provision for loan losses	3,550	5,277	5,156	11,280	25,263
Noninterest income (expense), net	(50,430)	(48,799)	(54,425)	(57,410)	(211,064)
(Provision) benefit for income taxes	(3,688)	1,194	1,823	(3,513)	(4,184)
Net income	$ 72,823	$ 81,527	$ 81,977	$ 76,220	$ 312,547

Note 21 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

	December 31,		
	2004	2003	2002
Cash, cash equivalents and investment securities	$ 3,748,672	$ 3,302,661	$ 2,512,937
Loans			
To District Associations	11,229,197	10,591,331	10,033,923
To Others	1,679,052	1,784,020	1,974,118
Total 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
Other assets	245,402	235,704	211,367
Total assets	$ 16,887,523	$ 15,879,548	$ 14,701,190
Bonds and notes	$ 15,402,385	$ 14,507,105	$ 13,538,536
Mandatorily redeemable preferred stock	225,000	225,000	—
Other liabilities	235,842	192,911	179,970
Total liabilities	15,863,227	14,925,016	13,718,506
Mandatorily redeemable preferred stock	—	—	225,839
Perpetual preferred stock	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 equity	$ 16,887,523	$ 15,879,548	$ 14,701,190

Statement of Income

	Year Ended December 31,		
	2004	2003	2002
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	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 expenses	2,160	1,556	1,732
Total noninterest expenses	64,602	73,621	77,798
Net income	$ 180,306	$ 177,449	$ 194,133