AgFirst Farm Credit Bank and District Associations

2005 ANNUAL REPORT

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Management

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

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Message from the Chairman of the Board and Chief Executive Officer

Dear Shareholders:

In our 2004 Annual Report, we highlighted a number of factors indicating that AgFirst and District Associations are successfully serving our shareholders. These factors included increasing loan volume, healthy market share, good credit quality, record profits, and substantial distributions to borrowers. We are happy to report that the success we enjoyed in 2004 carried forward into 2005.

- **Growth & Market Share** — Agricultural economists have indicated that 2005's net farm income will be a near-record $72.6 billion, a level exceeded only by the previous year's $82.5 billion. While levels of farm income have reduced loan demand in some agricultural sectors, we continued to grow and maintain a strong market share position in 2005, with loan volume increasing by more than $1.3 billion, or 9.00 percent, from December 31, 2004 to December 31, 2005.

- **Credit Quality —** Hurricanes Katrina, Rita and Wilma swept across the South and Southeast in late 2005, causing severe flooding and destruction in portions of Louisiana, Mississippi, Alabama, and Florida. Although these storms caused substantial damage to crops, livestock and home in the affected arrears, we have not seen a significant impact on credit quality in those areas.

  Our credit quality remains high, with 95.75 percent of loans outstanding at December 31, 2005 classified as "acceptable" and delinquencies at only 0.63 percent of total loans.

  Because poultry operations represent 13 percent of our loan volume, we are closely following reports of avian influenza in other parts of the world and have conducted research to assess the probability of the disease spreading to the U.S. We are optimistic at this point that the trade restrictions and other steps taken by the USDA will adequately protect the people and poultry industry of the U.S. We will continue to monitor this situation and will take appropriate actions, if necessary.

- **Earnings** — Final net income totaled $377 million in 2005. Final net income in 2004, excluding the impact of a one-time reversal of allowance for loan losses, totaled $320 million.

- **Distributions** — Our positive results translated into substantial distributions to our borrowers, totaling over $200 million for 2005.

We continue to focus on improving operating efficiencies. In 2005, we implemented upgrades to our loan origination and processing systems to make us more secure, efficient and easier for our customers to do business with. In 2006 and beyond, we will move forward with developing new products that have the same objectives.

In late 2004, the Farm Credit System launched HORIZONS, a forward-looking planning initiative focused on meeting the future financial needs of the next generation of farmers, ranchers and rural residents and a changing Rural America. The goal of HORIZONS is to help Farm Credit prepare for the future so that we may fully meet the evolving needs of our customers.

Throughout 2005, many AgFirst and association directors and employees participated in the marketplace assessments, research and analysis that became the foundation of HORIZONS. Working together with others across the nation, we learned that U.S. agriculture and rural communities must have access to capital, financial services and expertise to sustain a strong economic future.

Over the past 90 years, the District has been dedicated to the mission of improving the quality of life on the farm and in rural areas throughout our part of America. By any measure, we have succeeded; and, by any measure, we will succeed for the next 90 years and beyond.

Robert G. Sexton

Robert G. Sexton
Chairman of the Board

F. A. Lowrey

F. A. (Andy) Lowrey
Chief Executive Officer

March 1, 2006

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. AgFirst and each District Association 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 auditors, 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 2005 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.

Robert G. Sexton

Robert G. Sexton
Chairman of the Board

F. A. Lowrey

F. A. Lowrey
Chief Executive Officer

Leon T. Amerson

Leon T. Amerson
Chief Financial Officer

March 1, 2006

Five-Year Summary of Selected Combined Financial Data

(UNAUDITED)

(dollars in thousands)	December 31, 2005	2004	2003	2002	2001
Combined Balance Sheet Data					
Cash and cash equivalents	$ 640,830	$ 522,862	$ 527,250	$ 444,457	$ 339,541
Investment securities	5,302,965	3,290,967	2,832,716	2,153,118	1,663,323
Loans	16,171,572	14,836,278	14,336,779	13,823,089	12,877,889
Less: allowance for loan losses	87,551	95,419	316,735	311,180	301,615
Net loans	16,084,021	14,740,859	14,020,044	13,511,909	12,576,274
Other property owned	3,646	3,433	2,253	4,828	5,925
Other assets	743,098	437,295	313,654	312,689	376,630
Total assets	$ 22,774,560	$ 18,995,416	$ 17,695,917	$ 16,427,001	$ 14,961,693
Obligations with maturities of one year or less	$ 7,710,389	$ 6,586,537	$ 6,482,632	$ 6,357,834	$ 8,101,242
Obligations with maturities greater than one year	11,694,786	9,184,234	8,426,554	7,562,772	4,354,069
Mandatorily redeemable preferred stock	225,000	225,000	225,000	—	—
Total liabilities	19,630,175	15,995,771	15,134,186	13,920,606	12,455,311
Mandatorily redeemable preferred stock	—	—	—	225,839	225,839
Perpetual preferred stock	150,000	150,000	150,000	—	—
Protected borrower equity	7,628	10,123	12,453	15,486	19,261
Capital stock and participation certificates	120,370	125,089	128,099	124,541	127,271
Retained earnings					
Allocated	925,919	849,626	792,168	756,525	733,378
Unallocated	1,943,444	1,861,476	1,587,934	1,494,659	1,393,592
Accumulated other comprehensive income (loss)	(2,976)	3,331	(108,923)	(110,655)	7,041
Total shareholders' equity	3,144,385	2,999,645	2,561,731	2,280,556	2,280,543
Total liabilities and shareholders' equity	$ 22,774,560	$ 18,995,416	$ 17,695,917	$ 16,427,001	$ 14,961,693
Combined Statement of Income Data					
Net interest income	$ 610,501	$ 568,826	$ 575,913	$ 553,058	$ 484,332
Provision for (reversal of) loan losses	(6,492)	(213,388)	8,153	25,263	20,296
Noninterest income (expense), net	(239,816)	(247,003)	(248,129)	(215,248)	(160,795)
Net income	$ 377,177	$ 535,211	$ 319,631	$ 312,547	$ 303,241
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	1.86%	2.96%	1.88%	2.04%	2.15%
Total shareholders' equity	12.05%	19.31%	13.03%	13.28%	13.67%
Net interest income as a percentage of average earning assets	3.07%	3.16%	3.40%	3.63%	3.46%
Net chargeoffs (recoveries) to average loans	0.01%	0.05%	0.02%	0.12%	0.03%
Total shareholders' equity to total assets	13.81%	15.79%	14.48%	13.88%	15.24%
Debt to shareholders' equity (:1)	6.24	5.33	5.91	6.10	5.46
Allowance for loan losses to loans	0.54%	0.64%	2.21%	2.25%	2.34%
Permanent capital ratio (Bank only)	23.90%	26.86%	25.99%	22.91%	20.70%
Total surplus ratio (Bank only)	23.84%	26.76%	25.79%	22.69%	19.86%
Core surplus ratio (Bank only)	14.15%	15.60%	14.45%	13.20%	10.39%
Collateral ratio (Bank only)	105.70%	106.88%	106.94%	105.94%	106.38%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 98,354	$ 80,466	$ 67,792	$ 64,846	$ 70,621
Qualified allocated surplus	26,391	28,684	46,636	50,936	75,336
Nonqualified allocated surplus	83,420	65,666	47,154	42,261	29,946
Nonqualified retained surplus	73,653	74,467	48,391	32,402	21,165
Stock dividends	311	60	84	90	274
Mandatorily redeemable preferred stock dividend	—	—	10,282	18,887	10,912
Perpetual preferred stock dividend	10,950	10,950	1,851	—	—

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

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 (Associations or District 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, 2005, the District was comprised of AgFirst, its wholly owned subsidiary, the Farm Credit Finance Corporation of Puerto Rico (the Finance Corporation), and twenty-three Agricultural Credit Associations (the Associations). AgFirst provides 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.

The operations of the Finance Corporation were suspended effective December 31, 2005. The Board of Directors of the Finance Corporation determined there was insufficient financial benefit resulting from island-based tax treatment of the corporation to justify continuing the operations of the corporation at this time. All outstanding capital of the Finance Corporation was transferred to AgFirst on December 31, 2005. This will not have a material effect on the financial condition of the AgFirst District.

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 (FCBs) and an Agricultural Credit Bank (ACB), 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 FCB 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 FCB 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 22, *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.

CRITICAL ACCOUNTING POLICIES

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The District considers significant accounting policies to be critical to the understanding of the District's results of operations and financial position because some accounting policies require complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Combined Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses inherent in its loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, geographic, industry and other factors.

  Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. 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.

MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated a program to stimulate economic growth and development in rural areas. Recognizing that different investment strategies are needed for agricultural and rural communities, the FCA outlined a program to allow System institutions to hold investments, subject to approval by the FCA on a case-by-case basis. FCA has approved the Rural Housing Mortgage-Backed Securities pilot program, the Rural America Bond pilot and the Tobacco Buyout programs under the mission-related investments umbrella, as described below.

Rural Housing Mortgage-Backed Securities

In May 2005, AgFirst received approval from the FCA to purchase and hold Rural Housing Mortgage-Backed Securities (RHMBS) under its Mission-Related Investments Pilot Program. The RHMBS must be fully guaranteed by a government agency or GSE. The rural housing loans backing the RHMBS must be conforming first-lien residential mortgage loans originated by non-Farm Credit System lenders in "rural areas" as defined by the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill), or eligible rural housing loans originated by System lenders under FCA Regulation section 613.3030. This program should increase liquidity for rural housing loans resulting in more cost-effective credit to homeowners in rural America by providing an incentive to lenders to create RHMBS for sale in the secondary market. Investment securities at December 31, 2005 included $1.35 billion in RHMBS classified as held-to-maturity.

Rural America Bonds

In October 2005, FCA approved this investment program for AgFirst and the Associations. In recognition of the economic interdependence between agricultural and rural communities, AgFirst institutions seek to safely and soundly invest in debt obligations that support farmers, ranchers, agribusinesses, and their rural communities and businesses. In doing so, AgFirst institutions hope to increase the well-being and prosperity of American farmers, ranchers, and rural areas and residents. The FCA approved the Rural America Bonds investment program for a three-year pilot period. As of December 31, 2005, the AgFirst District Associations had $1.5 million in the Rural America Bond program. AgFirst and the Associations are actively planning to evaluate more opportunities in 2006.

Tobacco Buyout Program

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provides for payments to tobacco "quota owners" and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

The FCA determined that System institutions are "financial institutions" within the meaning of the Tobacco Act and are therefore eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA's goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

For the year ended December 31, 2005, thirteen District Associations held loan assignments for Tobacco Buyout borrowers and/or Successor-in-Interest Contracts (SIIC). As of December 31, 2005, the District Associations held Tobacco Buyout loan assignments of $84.8 million and SIIC of $237.2 million. In addition, the District Associations also had commitments to purchase SIIC of $112.7 million.

LOAN PORTFOLIO

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.

Loan Types

(dollars in thousands)	2005		2004		2003*	
Production agriculture:						
Real estate mortgage	$ 7,401,816	46%	$ 6,890,364	46%	$ 6,315,505	44%
Production and intermediate-term	6,378,740	40	5,868,713	40	5,412,454	38
Agribusiness:						
Loans to cooperatives	164,776	1	137,474	1	396,000	3
Processing and marketing	682,709	4	603,081	4	268,113	2
Farm-related business	369,574	2	336,434	2	201,181	1
Communication	33,423	–	85,269	1	166,858	1
Energy	156,006	1	176,397	1	234,677	2
Rural residential real estate	959,353	6	720,740	5	800,123	5
Lease receivables	22,525	–	15,906	–	3,413	–
Discounted loans to OFIs	2,650	–	1,900	–	500	–
Other	–	–	–	–	537,955	4
Total	$ 16,171,572	100%	$ 14,836,278	100%	$ 14,336,779	100%

* *Beginning with year-end 2004, loan type categories have been expanded to provide additional information on the types of loans made. As a result, 2003 would reflect old loan types.*

Loans outstanding as of December 31, 2005 totaled $16.17 billion, an increase of 8.96 percent and 12.76 percent compared to December 31, 2004 and 2003, respectively. District loan growth in originations 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, 2005, the District collectively had $1.67 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	2005	2004	2003
North Carolina	15%	15%	16%
Florida	15	15	14
Georgia	12	12	11
Virginia	11	11	11
Pennsylvania	10	10	10
Maryland	7	7	6
South Carolina	6	6	7
Ohio	4	4	4
Alabama	3	3	3
Kentucky	3	3	3
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	5	6
Total	100%	100%	100%

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

During the third quarter of 2005, hurricane activity caused damage across a significant portion of the AgFirst District. Louisiana, Mississippi, Alabama, and southern Florida were the areas most impacted. Crop and commodity damage in certain areas was severe, but the impact on repayment of loans and risk of loss appears to be mitigated by insurance proceeds, disaster relief, and the overall financial health of the borrowers' balance sheets.

RISK MANAGEMENT

Overview

The System is in the business of making agricultural and other loans that requires taking certain risks in exchange for compensation for the risks undertaken. Management of risks inherent in District business is essential for current and long-term financial performance. The goal is to identify and assess risk, and to properly and effectively mitigate, measure, price, monitor and report risks in the business activities.

The major types of risks are:

- *structural risk* — risk inherent in the business and related to the District structure (an interdependent network of lending institutions),
- *credit risk* — risk of loss arising from an obligor's failure to meet the terms of its contract or failure to perform as agreed,
- *interest rate risk* — risk that changes in interest rates may adversely affect the operating results and financial condition,
- *liquidity risk* — risk of loss arising from the inability to meet obligations when they come due without incurring unacceptable losses,
- *operational risk* — risk of loss resulting from inadequate or failed internal processes or systems, errors by employees or external events, and
- *political risk* — risk of loss of support for the System and agriculture by the U.S. government.

Structural Risk Management

Structural risk results from the fact that AgFirst, along with the Associations is part of the System, which is comprised of banks and associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, this structure at times requires action by consensus or contractual agreement. The 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 System banks fund association loans, with Systemwide debt. (See Note 9, *Bonds and Notes*, in the Notes to the Combined Financial Statements for further discussion.) The banks are jointly and severally liable for the payments of Systemwide Debt Securities, exposing each bank to the risk of default of the others.

In order to mitigate this risk, the System banks, including AgFirst, utilize two integrated contractual agreements — the Amended and Restated Contractual Interbank Performance Agreement, or CIPA, and the Amended and Restated Market Access Agreement, or MAA. Under provisions of the CIPA, a score is calculated that measures the financial condition and performance of each district using various ratios that take into account the district and bank capital, asset quality, earnings, interest-rate risk and liquidity. Based on these measures, the CIPA establishes an agreed-upon standard of financial condition and performance that each district must achieve and maintain. The CIPA also establishes economic incentives whereby monetary penalties are applied if the performance standard is not met. These penalties will occur at the same point at which a bank would be required to provide additional monitoring information under the MAA.

The MAA establishes criteria and procedures for the banks, to provide certain additional information and, under specified circumstances, for restricting or prohibiting an individual bank's participation in issuances of Systemwide Debt Securities. The MAA promotes the identification and resolution of individual bank financial problems in a timely manner and discharges the Funding Corporation's statutory responsibility for determining conditions of participation for each bank's participation in each issuance of Systemwide Debt Securities.

During the three years ended and as of December 31, 2005, all banks met the agreed-upon standard of financial condition and performance required by the CIPA and MAA.

Credit Risk Management

Credit risk arises from the potential inability of an obligor to meet its repayment obligation and exists in outstanding loans, letters of credit, unfunded loan commitments, investment portfolio and derivative counterparty credit exposures. The District manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual borrower. The District sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based on cash flows from operations or other sources of income, including non-farm income. Long-term real estate loans must be secured by first liens on the real estate (collateral). As required by regulation, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures. In addition, each loan is assigned a credit risk rating based on the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths and weaknesses and risks in a particular relationship. In addition, borrower and commodity concentration lending limits have been established to manage credit exposure.

A two-dimensional loan risk rating structure, incorporating a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss-given-default is used. The loan rating structure calculates estimates of loss through two components, borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, collateral).

Through its participation in loans or interests in loans to/from other institutions within the System or outside the System, the District limits its exposure to either a borrower or commodity concentration. This also allows the District to manage growth and capital, and to improve geographic diversification. Concentration risk is reviewed and measured by industry, product, geography and customer limits.

The District loan portfolio is divided into performing and high-risk categories. The high-risk assets, including accrued interest, are detailed below:

(dollars in thousands)	2005	2004	2003
High-risk Assets			
Nonaccrual loans	$ 82,812	$ 101,749	$ 121,066
Restructured loans	3,151	3,556	4,328
Accruing loans 90 days past due	2,353	2,034	2,804
Total high-risk loans	88,316	107,339	128,198
Other property owned	3,646	3,433	2,253
Total high-risk assets	$ 91,962	$ 110,772	$ 130,451
Ratios			
Nonaccrual loans to total loans	0.51%	0.69%	0.84%
High-risk assets to total assets	0.40%	0.58%	0.74%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased $18.9 million, or 18.61 percent in 2005.

Restructuring of loans occurs when a concession is granted to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay toward the loan are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

AgFirst and the District Associations review the credit quality of the loan portfolio on an on-going basis as part of risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

Credit quality within the District portfolio improved during the twelve months ended December 31, 2005. At year-end, the District's loans including interest were classified as follows:

Credit Quality	2005	2004	2003
Acceptable	95.75%	94.50%	92.81%
OAEM	2.67	3.32	4.76
Adverse*	1.58	2.18	2.43
Total	100.00%	100.00%	100.00%

* *Adverse loans include substandard, doubtful, and loss loans.*

Delinquencies were 0.63 percent of total loan assets at year-end 2005 compared to 0.42 percent and 0.53 percent at year-end 2004 and 2003, respectively. Nonperforming assets for the District represented 0.40 percent of total assets or $92.0 million, compared to 0.58 percent or $110.8 million for 2004, and 0.74 percent or $130.5 million for 2003. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

District net chargeoffs of $1.4 million, $7.9 million and $2.6 million were recorded in 2005, 2004, and 2003, respectively. As a percentage of total loan assets, net chargeoffs for the District were 0.01 percent for 2005 compared to 0.05 percent and 0.02 percent in 2004 and 2003, respectively.

Although the 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. Commodity and industry categories are based on the Standard Industrial Classification system published by the federal government. This system is used to assign commodity or industry categories based on the largest agricultural commodity of the customer. The following table/chart illustrates the aggregate credit portfolio of the District by major commodity segments.

	Percent of Portfolio		
Commodity Group	**2005**	**2004**	**2003**
Poultry	13%	12%	12%
Forestry	12	11	10
Cattle	8	8	8
Grain	7	7	7
Rural home	7	5	5
Dairy	6	7	7
Nursery/Greenhouse	5	5	5
Lumber/Paper	3	4	3
Swine	3	3	4
Tobacco	3	3	3
Cotton	3	3	3
Citrus	2	2	3
Utilities	1	2	3
Other	27	28	27
Total	100%	100%	100%

The table below segregates part-time farm loans for the District in a separate segment.

	Percent of Portfolio		
Commodity Group	**2005**	**2004**	**2003**
Part-time Farmers	37%	36%	35%
Poultry and Eggs	10	10	10
Dairy	6	7	7
Forestry	6	7	7
Nursery/Greenhouse	4	4	4
Cotton	3	3	3
Swine	3	3	3
Tobacco	2	2	2
Cattle	3	2	2
Corn	1	1	1
Other	25	25	26
Total	100%	100%	100%

The District has concentrations of full-time farmers greater than 5.00 percent in only three commodities-poultry, dairy, and forestry. All three commodities 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 disbursed as production is segregated between chicken, turkey, and egg production. Dairy herds range in size from less than 100 cows to approximately 10 thousand. The District also manages the credit and concentration risk through participations, guarantees, and direct payment assignments from the poultry integrators and milk processing facilities. Forestry is divided principally into hardwood and softwood production and value added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations. Softwood timber production is typically located in the coastal plains of the AgFirst footprint and is utilized for building material for the housing market and pulp to make paper and hygiene products. Forestry production at the Associations ranges from less than fifty acres to thousands of acres; value added processing is conducted at sawmills and planer mills. Also, many poultry, dairy, and forestry producers have significant secondary income from off-farm employment by a family member.

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 the Associations' own lending staff prior to an Association committing to such loans. Association individual loan exposures totaling $5.0 million or greater, which represent the commercial and corporate side of agribusiness, comprise approximately 7.70 percent of Association loan volume.

Approximately 47.66 percent of Association outstanding loan volume is comprised of loans under $500 thousand, and loans less than $100 thousand make up 11.85 percent of loan volume. This diversification among borrowers is another key component of the Associations' stable credit quality and solid financial performance over time.

Typically short and long term loans to the same borrower are cross-collateralized and cross-defaulted. By law, all long-term loans must be secured by a first lien on real estate with an initial loan to appraised value not exceeding 85.00 percent. As of December 31, 2005, 52.86 percent of the Association loans were identified as real estate loans. Exposure to losses is reduced through collateralization.

Gross Loans Per Borrower

$ Range	% of Total
$1-$50,000	5 %
$50,001 to $100,000	7
$100,001 to $250,000	18
$250,001 to $500,000	18
$500,001 to $1,000,000	18
$1,000,001 to $3,000,000	19
$3,000,00, to $5,000,000	7
$5,000,000 and above	8
Total	100 %

AgFirst and each Association maintain an allowance for loan losses determined by its management and is capitalized to serve its unique market. The minimum regulatory capital ratios for System banks and associations are 7.00 percent for the permanent capital ratio and 3.50 percent for the core surplus ratio. The table below illustrates the risk bearing capacity for the District.

District Entity	Regulatory Permanent Capital Ratio	Regulatory Core Surplus Ratio	Allowance/ Loans
AgFirst Farm Credit Bank	23.90%	14.15%	0.07%
AgChoice	14.39%	11.57%	0.31%
Ag Credit	18.73%	14.74%	0.47%
AgGeorgia	14.64%	9.60%	1.36%
AgSouth	16.81%	12.71%	0.33%
Cape Fear	16.95%	13.24%	0.66%
Carolina	16.39%	12.24%	0.24%
Central Florida	15.36%	12.70%	0.53%
Central Kentucky	14.72%	12.33%	0.94%
Chattanooga	14.32%	10.89%	0.49%
Colonial	17.48%	15.64%	0.47%
East Carolina	16.88%	13.29%	1.72%
Farm Credit of the Virginias	15.08%	12.00%	0.23%
First South	13.63%	10.40%	0.55%
Jackson Purchase	15.17%	13.37%	0.48%
MidAtlantic	15.31%	12.42%	0.63%
North Florida	13.81%	11.53%	0.39%
Northwest Florida	12.54%	11.55%	0.34%
Pee Dee	14.59%	11.94%	0.35%
Puerto Rico	24.02%	23.59%	0.09%
South Florida	16.76%	14.44%	1.09%
Southwest Florida	18.07%	12.63%	0.07%
Southwest Georgia	13.04%	10.54%	0.19%
Valley	14.10%	10.09%	0.44%

Interest Rate Risk Management

The AgFirst District 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 asset/liability management process is to generate a stable and adequate level of net interest income in any interest rate environment. Sophisticated analytical techniques are used to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of 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 the District's projected change in net interest income and market value of equity for various rate movements as of December 31, 2005.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+2.0% Shock	$647,092	6.68%
+1.0% Shock	$628,488	3.61%
Base line	$606,586	–
-1.0% Shock	$590,503	(2.65%)
-2.0% Shock	$600,027	(1.08%)

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity*	% Change
Book Value	$22,774,560	$19,780,175	$2,994,385	–
+2.0% Shock	$22,086,988	$19,224,726	$2,862,262	(1.89%)
+1.0% Shock	$22,267,751	$19,376,841	$2,890,910	(0.90%)
Base line	$22,446,594	$19,529,341	$2,917,253	–
-1.0% Shock	$23,026,923	$19,970,913	$3,056,010	4.76%
-2.0% Shock	$23,034,057	$19,975,064	$3,058,993	4.86%

* *For interest rate risk management, the $150.0 million in perpetual preferred stock is included in liabilities rather than equity.*

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2005. 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
(dollars in thousands)

	0 to 6 Months	6 months to 1 Year	1 to 5 Years	Over 5 Years	Total
Loans					
Fixed	$ 2,543,743	$ 1,138,130	$ 4,073,785	$ 2,175,109	$ 9,930,767
Variable	6,079,253	60,080	18,660	–	6,157,993
Nonaccrual	–	–	–	82,812	82,812
Total Loans	8,622,996	1,198,210	4,092,445	2,257,921	16,171,572
Cash and Investments	4,528,239	46,254	554,206	725,742	5,854,441
TOTAL INTEREST EARNING ASSETS	$ 13,151,235	$ 1,244,464	$ 4,646,651	$ 2,983,663	$ 22,026,013
Source of Funds					
Interest Bearing Liabilities	$ 8,482,713	$ 1,616,000	$ 7,078,000	$ 1,727,000	$ 18,903,713
Mandatorily Redeemable Preferred Stock	–	–	–	225,000	225,000
Perpetual Preferred Stock	–	–	–	150,000	150,000
Interest Rate Swaps	1,740,000	(425,000)	(1,215,000)	(100,000)	–
Equity	–	–	–	2,747,300	2,747,300
TOTAL SOURCE OF FUNDS	$ 10,222,713	$ 1,191,000	$ 5,863,000	$ 4,749,300	$ 22,026,013
Interest Rate Sensitivity Gap	$ 2,928,522	$ 53,464	$ (1,216,349)	$ (1,765,637)	
Sensitivity Gap as a % of Total Earning Assets	13.30%	0.24%	(5.52%)	(8.02%)	
Cumulative Gap	$ 2,928,522	$ 2,981,986	$ 1,765,637	$ –	
Cumulative Gap as a % of Total Earning Assets	13.30%	13.54%	8.02%	–	
Rate Sensitive Assets/Rate Sensitive Liabilities	1.29	1.04	0.79	0.63	

At December 31, 2005, the Repricing/Maturity Gap reflected an asset sensitive position. Short- and intermediate-term interest rates increased during the year and resulted in all call options on fixed rate debt to be “out of the money.” The asset sensitive repricing position implies an increase in net interest income given rising interest rates scenario. However, the Repricing/ Maturity Gap Analysis is a point in time view and is representative of the interest rate environment at December 31. Increasing or decreasing interest rates alter this position due to options in both assets and debt.

The Net Interest Income (NII) sensitivity analysis as shown above indicates that in +1.00 percent and + 2.00 percent interest rate shocks, the District is asset-sensitive resulting in a projected increase in NII of 3.61 percent and 6.68 percent respectively. In a falling rate environment, the NII analysis indicates a projected drop in NII by -2.65 percent and -1.08 percent in the downward shocks of 1.00 percent and 2.00 percent respectively. In the falling rate shock scenarios, the advantage in exercising call options of debt is offset by the impact of the asset-sensitive repricing position of the balance sheet.

At December 31, 2005, AgFirst had outstanding interest rate swaps with notional amounts totaling $2.63 billion and purchased interest rate caps with notional amounts totaling $239.0 million. 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. See Note 19, *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, 2005.

Disclosures for Derivative Financial Instruments

(dollars in millions)

Notional amounts	Receive Fixed	Amortizing Pay Fixed	Amortizing Floating for Floating	Interest Rate Caps	Total
Balance at December 31, 2004	$ 1,355	$ –	$ 500	$ 1,806	$ 3,661
Additions	625	440	–	–	1,065
Maturities/amortizations	(25)	–	(236)	(1,567)	(1,828)
Terminations	(25)	–	–	–	(25)
Balance at December 31, 2005	$ 1,930	$ 440	$ 264	$ 239	$ 2,873

Various Uses of Derivative Instruments at December 31, 2005

(dollars in millions)

Derivatives utilized to create synthetic floating-rate debt to achieve a lower cost of funding	$ 1,930
Asset/liability management purposes	804
Other purposes	139
Total interest rate swaps and caps outstanding	$ 2,873

Liquidity Risk Management

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 an FCB may hold certain eligible investments, in an amount not to exceed 35.00 percent of its total loans outstanding to satisfy FCA’s liquidity reserve requirement, manage short-term funds, and manage interest rate risk. AgFirst maintains an investment portfolio for this purpose comprised primarily of short-duration, high-quality investments. The nature of this portfolio guarantees that investments can be converted to cash quickly and without significant risk of loss.

In addition, the District maintains a portfolio of investments that are not held for liquidity purposes and are accounted for as a held-to-maturity portfolio. These investments are authorized by FCA Regulations that allow investments in Farmer Mac securities and also in specific investments approved by FCA as a Mission-Related Investment. The vast majority of this portfolio is comprised of Mission-Related Investments for a program to purchase RHMBS, not to exceed 10.00 percent of total outstanding loans (see *Mission-Related Investments* section). One Association also holds investment securities in AAA-rated asset-backed securities (ABSs) guaranteed by the full faith and credit of the United States Government.

Investment securities and cash equivalents outstanding as of December 31, 2005 for the District totaled $5.85 billion compared to $3.73 billion and $3.30 billion at December 31, 2004 and 2003, respectively. The increase in 2005 is due to revision of FCA Regulations during 2005 to increase the maximum level of liquidity investments from 30.00 to 35.00 percent of total loans outstanding, growth of total loans outstanding and AgFirst participating in the Mission-Related Investment program for rural housing.

The District's investment portfolio consisted of the following security types as of December 31, 2005:

District Investment Securities

(dollars in thousands)	2005		2004		2003	
Investment Securities						
Available for Sale						
Commercial Paper	$ 69,796	1.19%	$ 29,957	0.80%	$ 229,879	6.96%
U.S. Govt. GNMA MBS/CMOs	1,056,283	18.04	1,080,843	28.96	911,176	27.60
U.S. Govt. Agency MBS	2,029,961	34.67	1,853,148	49.66	1,634,415	49.51
Non-Agency Whole Loans	597,670	10.21	292,545	7.84	20,275	0.61
Commercial MBS	–	–	–	–	1,717	0.05
Asset-backed Securities	132,608	2.27	21,921	0.59	35,254	1.07
Total Available for Sale	3,886,318	66.38	3,278,414	87.85	2,832,716	85.80
Held-to-Maturity						
Rural Housing MBS	1,347,266	23.01	–	–	–	–
Commercial MBS	2,762	0.05	–	–	–	–
MBS Guaranteed by Farmer Mac	31,937	0.55	12,553	0.34	–	–
Asset-backed Securities	34,682	0.59	–	–	–	–
Total Held-to-Maturity	1,416,647	24.20	12,553	0.34	–	–
Total Investment Securities	5,302,965	90.58	3,290,967	88.19	2,832,716	85.80
Cash Equivalents						
Fed Funds	168,428	2.88	58,691	1.57	108,700	3.29
Master Notes	108,048	1.84	107,000	2.87	109,935	3.33
Repos	275,000	4.70	275,000	7.37	250,000	7.58
Total Cash Equivalents	551,476	9.42	440,691	11.81	468,635	14.20
Total Investment Portfolio	$ 5,854,441	100.00%	$ 3,731,658	100.00 %	$ 3,301,351	100.00%

FCA regulations require a liquidity policy that establishes 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, 2005, AgFirst's coverage was 201 days.

Systemwide Debt Securities

AgFirst's primary source of liquidity is the ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds to support the mission to provide credit and related services to the rural and agricultural sectors, repay maturing Systemwide Debt Securities, and meet other obligations. As a government-sponsored enterprise, AgFirst has had access to the nation's and world's capital markets. This access has provided AgFirst with a dependable source of competitively priced debt that is critical to support the mission of providing funding to the rural and agricultural sectors. Moody's Investors Service and Standard & Poor's rate System long-term debt as Aaa and AAA, respectively, and System short-term debt as P-1 and A-1, respectively. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's government-sponsored enterprise status. Material changes to the factors considered could result in a different debt rating. However, as a result of the System's financial performance, credit quality and standing in the capital markets, AgFirst anticipates continued access to funding necessary to support System needs. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities. At December 31, 2005, AgFirst had $18.88 billion in total debt outstanding compared to $15.40 billion at December 31, 2004 and $14.51 billion at December 31, 2003. The year-to-year increases were primarily due to the increases in loan volume and investments.

AgFirst's participation in outstanding Systemwide Debt Securities as of December 31, 2005 is as follows:

Systemwide Debt Securities
(dollars in thousands)

	Bonds		Medium-Term Notes		Discount Notes		Total	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
2006	$ 5,546,432	3.48%	$ –	–%	$ 1,726,225	3.87%	$ 7,272,657	3.57%
2007	4,709,288	3.89	15,202	6.75	–	–	4,724,490	3.89
2008	2,026,642	3.79	–	–	–	–	2,026,642	3.79
2009	1,643,669	4.23	–	–	–	–	1,643,669	4.23
2010	915,029	4.42	–	–	–	–	915,029	4.42
2011	2,297,477	5.18	–	–	–	–	2,297,477	5.18
Total	$ 17,138,537	3.98%	$ 15,202	6.75%	$ 1,726,225	3.87%	$ 18,879,964	3.97%

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

See Note 9, *Bonds and Notes,* in the Notes to the Combined Financial Statements, for additional information related to debt.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. AgFirst and the Associations' board of directors are required, by regulation, to adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs and resources. The policy must include, at a minimum, the following items:

- direction to management that assigns responsibility for the internal control function to an officer of the institution,
- adoption of internal audit and control procedures,
- direction for the operation of a program to review and assess its assets,
- adoption of loan, loan-related assets and appraisal review standards, including standards for scope of review selection and standards for work papers and supporting documentation,
- adoption of asset quality classification standards,
- adoption of standards for assessing credit administration, including the appraisal of collateral, and
- adoption of standards for the training required to initiate a program.

In general, System institutions address operational risk through the organization's internal framework under the supervision of the internal auditors. Exposure to operational risk is typically identified with the assistance of senior management and internal audit plans developed with higher risk areas receiving more review.

Political Risk Management

System institutions are instrumentalities of the federal government and are intended to further governmental policy concerning the extension of credit to or for the benefit of agricultural and rural America. The System and its borrowers may be significantly affected by federal legislation that affects the System directly, such as changes to the Farm Credit Act, or indirectly, such as agricultural appropriations bills. Political risk to the System is the risk of loss of support for the System or agriculture by the U.S. government.

The District manages political risk by actively supporting the Farm Credit Council, which is a full-service, federal trade association representing the System before Congress, the Executive Branch, and others. The Council provides the mechanism for "grassroots'' involvement in the development of System positions and policies with respect to federal legislation and government actions that impact the System. Additionally, the District takes an active role in representing the individual interests of System institutions and their borrowers before Congress. In addition to the Farm Credit Council, each district has its own Council, which is a member of the Farm Credit Council. The district Councils represent the interests of their members on a local and state level, as well as on a federal level.

ALLOWANCE FOR LOAN LOSSES

During 2004, the Bank and District Associations completed studies to further refine their allowance for loan losses methodologies taking into account guidance from 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 $215.4 million 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 unusually adverse economic factors affecting American agriculture. Subsequent estimates continued to reflect, to some extent, the loss history of the mid-to-late 1980s. 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, economic conditions, and historical loss experience, keeping in mind the potentially long agricultural cycle.

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 $3.23 billion (19.99 percent of the District's loans), as compared with $3.10 billion at December 31, 2004 (20.86 percent of the District's loans), and $2.88 billion at December 31, 2003 (20.08 percent of the District's loans).

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Loss Activity *(dollars in thousands)*	**Year Ended December 31, 2005**	**2004**	**2003***
Balance at beginning of year	$ 95,419	$ 316,735	$ 311,180
Charge-offs:			
Production agriculture:			
Real estate mortgage	(158)	(301)	–
Production and intermediate-term	(2,267)	(5,102)	–
Agribusiness	(161)	(1,248)	–
Communication loans	(13)	(3,200)	–
Rural home loans	(16)	(36)	–
Other	–	–	(5,885)
Total charge-offs	(2,615)	(9,887)	(5,885)
Recoveries			
Production agriculture:			
Real estate mortgage	43	34	–
Production and intermediate-term	777	1,905	–
Agribusiness	44	14	–
Communication loans	363	–	–
Rural home loans	12	6	–
Other	–	–	3,287
Total recoveries	1,239	1,959	3,287
Net (charge-offs) recoveries	(1,376)	(7,928)	(2,598)
Provision for (reversal of) loan losses	(6,492)	2,037	8,153
Reversal of provision due to change in methodology	–	(215,425)	–
Balance at end of year	$ 87,551	$ 95,419	$ 316,735
Ratio of net charge-offs during the period to average loans outstanding during the period	0.01%	0.05%	0.02%

* *Beginning with year-end 2004, loan type categories have been expanded to provide additional information on the types of loans made. As a result, three years of comparable data is not available.*

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type *(dollars in thousands)*	**December 31, 2005**	**2004**	**2003***
Production agriculture:			
Real estate mortgage	$ 35,676	$ 40,515	$ –
Production and intermediate-term	43,490	44,891	–
Agribusiness	6,289	6,487	–
Communication	80	1,504	–
Energy	55	76	–
Rural residential real estate	1,956	1,928	–
Leases	5	18	–
Other	–	–	316,735
Total	$ 87,551	$ 95,419	$ 316,735

* *Beginning with year-end 2004, loan type categories have been expanded to provide additional information on the types of loans made. As a result, three years of comparable data is not available.*

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

	2005	**2004**	**2003**
Allowance for loan losses to loans	0.54%	0.64%	2.21%
Allowance for loan losses to nonaccrual loans	105.72%	93.78%	261.62%
Allowance for loan losses to participation loans and correspondent lending loans	5.29%	8.13%	24.39%

The financial positions of the District borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level, due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of the District loan portfolio has remained healthy.

See 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 $377.2 million for the year ended December 31, 2005, a decrease of $158.0 million over 2004, while 2004 net income increased $215.6 million over 2003. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

Change in Net Income *(dollars in thousands)*	**Year Ended December 31, 2005**	**2004**
Net income (for prior year)	$ 535,211	$ 319,631
Increase (decrease) due to:		
Total interest income	297,591	41,189
Total interest expense	(255,916)	(48,276)
Net interest income	41,675	(7,087)
Provision for loan losses	(206,896)	221,541
Noninterest income	1,850	3,962
Noninterest expense	(7,158)	6,668
Provision for income taxes	12,495	(9,504)
Total increase (decrease) in net income	(158,034)	215,580
Net income	$ 377,177	$ 535,211

Interest Income

Total interest income for the year ended December 31, 2005 was $1.20 billion, an increase of $297.6 million, as compared to the same period of 2004. Total interest income for the year ended December 31, 2004 was $901.7 million, an increase of $41.2 million, as compared to the same period of 2003.

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

Net Change in Interest Income *(dollars in thousands)*	**Year Ended December 31, 2005-2004**	**2004-2003**
Increase in average earning assets	$ 1,864,089	$ 1,064,691
Average yield (prior year)	5.01%	5.08%
Interest income variance attributed to change in volume	93,324	54,064
Average earning assets (current year)	19,874,662	18,010,573
Increase (decrease) in average yield	1.02%	(0.07%)
Interest income variance attributed to change in yield	204,267	(12,875)
Net change in interest income	$ 297,591	$ 41,189

The increase from 2004 to 2005 resulted from increases related to volume and rate. The increase from 2003 to 2004 was primarily attributable to increases in average earning assets. The volume of interest earning assets increased in 2005, with an increase in average earning assets of $1.86 billion. In 2005, interest rates increased in comparison to 2004 and as a result, the average yield on interest earning assets increased by 1.02 percent.

Interest Expense

Total interest expense for the year ended December 31, 2005 was $588.8 million, an increase of $255.9 million, as compared to the same period of 2004. Total interest expense for the year ended December 31, 2004 was $332.9 million, an increase of $48.3 million, as compared to the same period of 2003. The increases in interest expense were primarily attributed to rising interest rates, and an increase in interest-bearing liabilities to support asset growth.

Prior to the adoption of Statement of Financial Accounting Standards (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 $225.0 million of mandatorily redeemable preferred stock in 2001 and $150.0 million 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, $9.4 million, which represents dividends from July 1, 2003 to December 31, 2003 on the $225.0 million mandatorily redeemable preferred stock, was reflected as interest expense rather than an adjustment to capital in 2003. In 2004 and 2005, the related interest expense was $18.9 million for both years.

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

Net Change in Interest Expense *(dollars in thousands)*	**Year Ended December 31,** 2005-2004	2004-2003
Increase in average interest-bearing liabilities	$ 1,792,935	$ 1,014,555
Average rate (prior year)	2.21%	2.03%
Interest expense variance attributed to change in volume of average interest-bearing liabilities	39,696	20,594
Average interest-bearing liabilities (current year)	16,827,020	15,034,085
Increase (decrease) in average rate	1.29%	0.18%
Interest expense variance attributed to change in rate	216,220	27,682
Net change in interest expense	$ 255,916	$ 48,276

Net Interest Income

Net interest income increased from 2004 to 2005, but decreased from 2003 to 2004, as illustrated by the following table:

Analysis of Net Interest Income

(dollars in thousands)

	2005		2004		2003	
	Avg. Balance	Interest	Avg. Balance	Interest	Avg. Balance	Interest
Loans	$ 15,414,929	$ 1,028,563	$ 14,429,728	$ 826,926	$ 13,951,128	$ 801,068
Cash & investments	4,459,733	170,711	3,580,845	74,757	2,994,754	59,426
Total earning assets	$ 19,874,662	$ 1,199,274	$ 18,010,573	$ 901,683	$ 16,945,882	$ 860,494
Interest-bearing liabilities	$ 16,827,020	$ (588,773)	$ 15,034,085	$ (332,857)	$ 14,019,530	$ (284,581)
Impact of capital	$ 3,047,642		$ 2,976,488		$ 2,926,352	
Net interest income		$ 610,501		$ 568,826		$ 575,913

	2005 Average Yield	2004 Average Yield	2003 Average Yield
Yield on loans	6.67%	5.73%	5.74%
Yield on cash & investments	3.83%	2.08%	1.98%
Yield on earning assets	6.03%	5.01%	5.08%
Cost of interest-bearing liabilities	3.50%	2.21%	2.03%
Spread	2.53%	2.79%	3.05%
Impact of capital	0.54%	0.37%	0.35%
Net interest income/avg. earning assets	3.07%	3.16%	3.40%

The increase in net interest income from 2004 to 2005 is primarily attributable to higher volumes of loans and investments, although interest spreads have declined by 26 basis points compared to 2004. This reduction in spread is due to previous years spread being unusually high as call options on fixed debt were exercised. As rates fell in previous years, debt was called and reissued at lower coupons faster than refinance speeds on fixed rate assets. This resulted in an unusually high spread. Over time, asset refinancing for fixed accounts eventually caught up and returned the spreads to a more normalized level. Other factors include an adverse impact on earnings margin due to flattening yield curves during 2005 and reduced loan spreads due to competitive pressures on commercial transactions.

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. A reversal of $6.5 million in 2005 primarily resulted from the net decrease in the risk exposure across the District. In 2005, a net reversal of $1.5 million and $5.0 million in provision for loan losses was recorded by the District Associations and AgFirst, respectively. 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 $8.2 million in 2003 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, 2005 was $55.6 million, an increase of $1.8 million, compared to 2004. The primary reasons for this increase was the $1.6 million increase in loan fees, the $1.1 million increase in gains on sales of mortgage servicing assets, and the $3.7 million increase in gains on sales of rural home loans, offset by the decreases in fees for financially related services of $197 thousand and in other noninterest income of $1.4 million. In addition, for the year ended December 31, 2004, AgFirst recorded a recovery of $3.4 million on an investment previously charged-off.

Noninterest income for the year ended December 31, 2004 was $53.7 million, an increase of $4.0 million, compared to 2003. The primary reason for this increase was the $3.4 million increase in the above-mentioned recovery on an investment previously charged-off, and the $3.8 million gain on the sale of stock of the Farm Credit Leasing Corporation, offset by the decrease of $2.0 million in loan fees.

Noninterest Expense

Noninterest expense for the year ended December 31, 2005 was $297.5 million, an increase of $7.2 million, compared to the same period of 2004. Noninterest expense for the year ended December 31, 2004 was $290.3 million, a decrease of $6.7 million, compared to the same period in 2003.

The following table illustrates the sources of variance.

(dollars in thousands)	Year Ended December 31, 2005	2004
Prior year noninterest expense	$ 290,343	297,011
Change in expense:		
Salaries and employee benefits	8,284	6,064
Occupancy and equipment	2,630	1,938
Insurance Fund premium	359	(9,091)
Other operating expenses	6,042	4,864
Intra-System financial assistance expense	(3,573)	(6,368)
Restructuring charge	(3,697)	3,697
Called debt expense	(2,704)	(8,376)
Other noninterest expenses	(183)	604
Noninterest expense	$ 297,501	$ 290,343

The Farm Credit System Insurance Corporation (FCSIC) targets a secure base amount equal to 2.00 percent of System obligations. The large decrease in from 2003 to 2004 of the FCSIC premiums was 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.

Intra-System financial assistance decreased $3.6 million from 2004 to 2005. Intra-System financial assistance decreased $6.4 million from 2003 to 2004. These decreases were due to the retirement of several Financial Assistance Corporation bonds. See Note 14, *Intra-System Financial Assistance,* in the Notes to the Combined Financial Statements for further information.

The restructuring charges of $3.7 million recorded in 2004 were the 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 $6.0 million from 2004 to 2005 and increased $4.9 million from 2003 to 2004. The $6.0 million increase in other operating expenses from 2004 to 2005 resulted from increases of $1.3 million in directors' expenses, $1.1 million in advertising expense, $1.0 million in communications expense, $590 thousand in purchased services expense, and $507 thousand in public and member relations expense. Directors' expenses increased in 2005 primarily as a result of a $453 thousand increase in compensation payments, a $420 thousand increase for payment by one Association for directors' severance and early retirement plans, and a $383 thousand increase in director travel and other expense. Advertising expense increased in 2005 primarily due to new District-wide advertising aimed at the growing "Lifestyle Farmer/Country Mortgages" market.

The increase in other operating expenses 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.

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. For 2005, the called debt expense was $656 thousand, a decrease of $2.7 million, compared to 2004. For 2004, the called debt expense was $3.4 million, a decrease of $8.3 million, compared to the comparable period in 2003. Falling interest rates in 2003 enabled AgFirst to call a substantial amount of debt resulting in the called debt expense of $11.7 million. Called debt volume was $352.0 million, $2.53 billion, and $8.59 billion for 2005, 2004, and 2003, respectively. Stable-to-rising rates in 2005 significantly reduced call opportunities.

Provision for Income Taxes

Provision for income taxes decreased $12.5 million in 2005 compared to 2004. Provision for income taxes increased $9.5 million in 2004 compared to 2003. These variations are primarily attributable to the reversal of the allowance for loan losses recorded in 2004. In connection with the reversal of the allowance for loan losses due to the refinement of methodologies, $11.2 million 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 thousand and $901 thousand in 2004 and 2003, respectively, which is included as a component of the 2004 and 2003 current income tax provision. See Note 12, *Income Taxes*, in the Notes to the Combined Financial Statements for further details.

EMPLOYEE RETIREMENT PLANS

As of December 31, 2005, the District had contributed $28.0 million to the Districtwide defined benefit retirement plans. As of December 31, 2004, the District had contributed $106.6 million to the Districtwide defined benefit retirement plans. The Districtwide funding in 2004 brought the retirement plans' assets to an amount that exceeded the Accumulated Benefit Obligation as of the plans' measurement date, eliminating the minimum pension liability and the charge to accumulated other comprehensive income. See Note 13, *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 thousand shares of Mandatorily Redeemable Cumulative Preferred Stock 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 AgFirst on any dividend payment date at its par value of $1 thousand per share.

On October 14, 2003, AgFirst issued 150 thousand shares of Perpetual Non-Cumulative Preferred Stock 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 or after the dividend payment date in December 2008, AgFirst may, at its option, redeem the preferred stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for the then current dividend period to the date of redemption.

See Note 10, *Mandatorily Redeemable Preferred Stock,* and Note 11, *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, 2005 was $3.14 billion, compared to $3.00 billion and $2.56 billion at December 31, 2004 and 2003, respectively. The increases in shareholders' equity are attributed to increases in retained earnings.

FCA sets minimum regulatory capital requirements for banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk-adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods presented, AgFirst and the Associations exceeded all minimum regulatory standards.

Subsequent to the issuance of the mandatorily redeemable preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent compared to the regulatory minimum of 103.00 percent. Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-weighting of assets.

At December 31, AgFirst's regulatory ratios were:

	Regulatory	AgFirst Ratio as of		
	Minimum	12/31/05	12/31/04	12/31/03
Permanent capital ratio	7.00%	23.90%	26.86%	25.99%
Total surplus ratio	7.00%	23.84%	26.76%	25.79%
Core surplus ratio	3.50%	14.15%	15.60%	14.45%
Collateral ratio	103.00% *	105.70%	106.88%	106.94%

* *FCA requires AgFirst to maintain a minimum net collateral ratio of 104.00 percent.*

The reduction in the AgFirst Bank-only permanent capital, total surplus, and core surplus ratios from December 31, 2003 to December 31, 2005 was primarily attributed to the growth in assets. AgFirst loan volume and investment securities increased 29.32 percent from December 31, 2003 to December 31, 2005, while capital only increased 8.68 percent for the same period.

See Note 11, *Protected Borrower Equity and Shareholders' Equity*, in the Notes to the Combined Financial Statements for additional information.

THE DISTRICTWIDE YOUNG, BEGINNING, AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

AgFirst's and the Associations' mission is to provide financial services to agriculture and the rural community, which includes providing credit to young*, beginning** and small*** farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Associations, the Associations have established annual marketing goals to increase market shares of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers access to a stable source of credit.

YBS farmers and ranchers are defined as:

* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

** Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

*** Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than $250 thousand in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

AgFirst and the District Associations recognize 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. AgFirst's affiliated Associations have sponsored and supported the majority of the YBS farmer programs throughout the District. In addition, AgFirst has sponsored YBS initiatives jointly with its Associations as well as supported individual state and national programs. The 2005 YBS program that AgFirst sponsored included numerous state Cooperative Councils. Management will continue to consider sponsorship of future, district-wide YBS farmer activities as opportunities arise.

All District Associations offer some types of credit and related services to YBS borrowers with 100.00 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, 2005 business activity with young, beginning, and small farmers, ranchers, and producers or harvesters of aquatic products:

AgFirst Farm Credit District
Young, Beginning, and Small Farmers and Ranchers
Number/Volume of Loans Outstanding
December 31, 2005
(dollars in thousands)

Category	Number of Loans	Volume Outstanding
Total loans and commitments outstanding	132,453	$20,540,198
Young farmers and ranchers	21,042	1,790,408
Beginning farmers and ranchers	31,875	3,604,104
Small farmers and ranchers	90,293	6,557,771

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

Number/Volume Outstanding by Loan Size
December 31, 2005

Number/Volume Outstanding	$0-$50,000	$50,000-$100,000	$100,001-$250,000	$250,001 and greater
Total number of loans and commitments outstanding	81,525	20,779	18,747	11,402
Total volume of loans and commitments outstanding	$1,577,358	$1,742,833	$3,389,900	$13,830,107

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 District would be immaterial in relation to the financial position of the District. See Note 17, *Commitments and Contingencies*, in the Notes to the Combined Financial Statements for additional information.

RECENT REGULATORY MATTERS

On February 24, 2004, the FCA published a final notice in the Federal Register that loan syndication transactions by System institutions to eligible borrowers must be treated as direct loans meeting all statutory and regulatory requirements, rather than as loan participations. In addition, FCA indicated that since FCBs 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.

Loan syndication transactions under the direct lending authorities now require associations to address borrower rights, territorial concurrency, and stock requirements. To date, the District has 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. However, the FCA ruling has resulted in higher cost and more complexity to achieve the same volume and resulted in slowing of growth opportunity. FCA subsequently adopted a regulation allowing the waiver of borrower rights under certain circumstances for loan syndication transactions.

In January 2006, FCA approved final governance regulations for System banks and associations. The regulations are intended to promote the continued safety and soundness of the System by establishing governance standards and improving transparency in public disclosures. While the regulation will require changes to governance processes/disclosures, it is not expected to materially impact District operations.

FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from the District's expectations and predictions due to a number of risks and uncertainties, many of which are beyond the District's control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

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	Leased
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 17 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 11 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, 8, 9, 10, 13, 14 and 17 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
Leon T. Amerson	Senior Vice President & Chief Financial Officer
Benjamin F. Blakewood	Senior Vice President, Chief Operations & Technology Officer
William L. Melton	Senior Vice President, Chief Lending 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, 2005, 2004 and 2003, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Perq./ Other*	Total
F. A. Lowrey	2005	$ 444,017	$ 162,332	$ 6,000	$ 16,779	$ 629,128
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
5 Officers	2005	$ 1,251,913	$ 311,804	$ 58,502	$ 65,204	$ 1,687,423
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

* *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, including financial measures and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2005 bonus was made in the first quarter of 2006.

Disclosure of the total compensation in 2005 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
Robert G. Sexton	Chairman	December 31, 2007
Thomas W. Kelly	Vice Chairman	December 31, 2008
E. McDonald Berryman	Director	December 31, 2005
William C. Bess, Jr.	Director	December 31, 2009*
Dr. Chester D. Black	Director	December 31, 2006#
Robert A. Carson	Director	December 31, 2006
Henry M. Frazee	Director	December 31, 2008
Don W. Freeman	Director	December 31, 2009*
Robert L. Holden, Sr.	Director	December 31, 2006
Paul M. House	Director	December 31, 2007
Lyle Ray King	Director	December 31, 2008
Richard Kriebel	Director	December 31, 2007
M. Wayne Lambertson	Director	December 31, 2009*
Paul Lemoine	Director	December 31, 2007
F. Merrel Lust	Director	December 31, 2005
James L. May	Director	December 31, 2009**
Eugene W. Merritt, Jr.	Director	December 31, 2006
Katherine A. Pace	Director	December 31, 2007##
Dale W. Player	Director	December 31, 2007
J. Dan Raines, Jr.	Director	December 31, 2009*
Walter L. Schmidlen, Jr.	Director	December 31, 2008
Kenneth A. Spearman	Director	December 31, 2009##
Robert H. Spiers, Jr.	Director	December 31, 2009**

* *These directors were re-elected to a new 4-year term ending 12/31/09.*
** *These directors were newly elected in 2005 to 4-year terms commencing 1/1/06.*
\# *Dr. Black resigned effective 12/31/05.*
\#\# *Newly appointed outside directors.*

Robert G. Sexton, 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.

Thomas W. Kelly, Vice Chairman of the Board, is from Tyrone, Pennsylvania and 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.

E. McDonald Berryman, a farmer from Elberon, Virginia, 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.

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders Supply Co., a retail farm equipment business, and has a 70-head cow-calf operation. He serves on the national Farm Credit Council Board, the Farm Credit System's national trade organization, and is a member of the Cleveland County and Catawba Cattlemen's Associations.

Dr. Chester D. Black of Raleigh, North Carolina, served 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.

Henry M. (Buddy) Frazee of Alachua, Florida, is a retired managing partner of a large cow-calf beef cattle and timber operation, headquartered in Gainesville, Florida. He is presently the Trustee of several land holding and development companies and owns commercial timberland. Along with his son, he manages a 2,000-acre game preserve and deer hound kennel. He currently serves on the board of Farm Credit of North Florida, ACA.

Don W. Freeman manages a 400-acre cow-calf operation in Montgomery, Alabama. He is a member of the national Farm Credit Council Board, Lowndes County Farmers Federation Board, and the Lowndes County Cattlemen's Association Board. He is also 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, Grady County Farm Bureau, American Dairy Association of Georgia, and First United Ethanol, LLC.

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.

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, ACA, Atlantic Telephone Membership Cooperative, and Landbank Resource Management, a real estate company.

Richard Kriebel is a contract farmer from Benton, Pennsylvania, raising contract vegetables, forage and grain. His cropland consists of owned-and-leased acres of corn, hay and vegetables. 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 with his two sons a 2,700-acre farm of corn, soybeans, and wheat, and a 300,000 capacity broiler operation. He is co-owner of a restaurant and partner in a development and construction company. He currently serves on the national Farm Credit Council Board, MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization.

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.

James L. May is owner and operator of Mayhaven Farm in Waynesboro, Kentucky, where he owns 250 acres and leases another 500 acres. He is involved in the development and marketing of 400 recipient heifers for embryo transfer each year. May's operation also includes 150 acres of alfalfa hay, 300 acres of corn and soybeans, and 100 acres of wheat. He currently serves as a member of the boards of Central Kentucky Ag Credit, Lincoln County Extension Council, and the Lincoln County Cattlemen's Association.

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.

Katherine A. Pace, from Orlando, Florida, is a certified public accountant with 22 years in public accounting. She provides consulting services to family owned businesses through her company Family Business Consulting, LLC. Previously, she was a tax partner with KPMG, LLP, an audit, tax and advisory service firm, from 1985-2005 where her practice included a variety of cooperative and agribusiness clients as well as participation in trade associations such as the National Society of Accountants for Cooperatives. She is a member of the American Institute of Certified Public Accountants and currently serves on the boards of several charitable and for profit organizations. She obtained her B.S. degree in accounting from Furman University.

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 beef producer from Ashburn, Georgia. His operations include commercial beef cattle, registered Angus cattle and timber. He serves as a director on the board of *Ag***Georgia** 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.

Kenneth A. Spearman, from Winter Haven, Florida, currently works for Florida's Natural Growers, Inc. as Director of Internal Audit. Prior to this, he worked as Controller for Citrus Central, Inc. from 1980-1991. He obtained his Masters Degree in Business Administration from Governors State University in University Park, Ill., and his B.S. degree in accounting from Indiana University. He serves as chairman of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, and the National Society of Accountants for Cooperatives, where he was also past National President.

Robert H. Spiers, Jr., is a full-time farmer, with a tobacco, peanut, soybean and cotton operation on 1,100 acres in Dinwiddie County, Virginia. He currently serves on the boards of Colonial Farm Credit, ACA, and Appomattox River Soil and Water Conservation District. He has been active in several farming organizations, including the Virginia Peanut Growers Association, Farm Service Agency and Virginia Farm Bureau.

Compensation of Directors

Directors were compensated in 2005 in cash at the rate of $27,060 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 $27,060 to board officers and board members represented compensation for service for Farm Credit Council (FCC) activities, including FCC board meetings, meetings with other district and national FCC representatives, congressional visitations, and other FCC board activities and issues. Total cash compensation paid to all directors as a group during 2005 was $605,340. Additional information for each director who served during 2005 is provided below.

	Number of Days Served			
Name of Director	Board Meetings	Farm Credit Council Bd. Activities	Other Official Activities**	Total Comp. Paid During 2005
E. McDonald Berryman	20	9.0	16.75	$ 31,860
William C. Bess, Jr.	23	9.0	12.75	31,860
Dr. Chester D. Black	20	9.0	13.25	31,860
Robert A. Carson	23	9.0	15.75	31,860
Henry M. Frazee	23	9.0	18.25	31,860
Don W. Freeman	23	9.0	12.25	31,860
Robert L. Holden, Sr.	23	9.0	13.75	31,860
Paul M. House	23	9.0	11.75	31,860
Thomas W. Kelly	23	10.0	16.75	31,860
Lyle Ray King	23	9.0	13.50	31,860
Richard Kriebel	22	5.0	15.00	31,860
M. Wayne Lambertson	23	9.0	16.50	31,860
Paul Lemoine	23	9.0	10.50	31,860
F. Merrel Lust	20	9.0	13.50	31,860
Eugene W. Merritt, Jr.	23	9.0	12.00	31,860
Dale W. Player	23	9.0	16.00	31,860
J. Dan Raines, Jr.	23	9.0	17.75	31,860
Walter L. Schmidlen, Jr.	23	9.0	15.25	31,860
Robert G. Sexton	23	9.0	16.25	31,860
Total				$ 605,340

** *Includes board committee meetings and board training.*

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $202,283 for 2005, $183,164 for 2004, and $181,020 for 2003.

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 15 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 Auditors

There were no material disagreements with our independent auditors 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 1, 2006, 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 annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, ***www.agfirst.com***. AgFirst prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no quarterly report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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 2005, 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 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 Company's Annual Report for 2005. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:

Paul House

Paul M. House
Chairman of the Audit Committee

Members of Audit Committee

Robert A. Carson
Richard Kriebel
Paul Lemoine
Katherine A. Pace
Walter L. Schmidlen, Jr.

March 1, 2006

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

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

Report of Independent Auditors

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 (the Bank) and District Associations (together, the District) at December 31, 2005, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 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

March 1, 2006

Combined Balance Sheets

(dollars in thousands)	December 31, 2005	December 31, 2004	December 31, 2003
Assets			
Cash and cash equivalents	$ 640,830	$ 522,862	$ 527,250
Investment securities:			
Available for sale (amortized cost of $3,888,889, $3,268,041 and $2,824,203 respectively)	3,886,318	3,278,414	2,832,716
Held to maturity (fair value of $1,384,390 and $12,816 respectively)	1,416,647	12,553	—
Total Investment securities	5,302,965	3,290,967	2,832,716
Loans	16,171,572	14,836,278	14,336,779
Less: allowance for loan losses	87,551	95,419	316,735
Net loans	16,084,021	14,740,859	14,020,044
Other investments	237,239	—	—
Accrued interest receivable	179,970	131,402	122,007
Investments in other Farm Credit System institutions	8,756	8,229	19,157
Premises and equipment, net	107,063	96,603	86,914
Other property owned	3,646	3,433	2,253
Deferred tax assets, net	1,691	2,229	13,303
Other assets	208,379	198,832	72,273
Total assets	$22,774,560	$18,995,416	$17,695,917
Liabilities			
Bonds and notes	$18,879,964	$15,402,385	$14,507,105
Mandatorily redeemable preferred stock (Note 10)	225,000	225,000	225,000
Accrued interest and dividends payable	133,855	65,854	52,025
Dividends and patronage refunds payable	99,665	81,607	68,885
Postretirement benefits other than pensions	102,681	92,970	79,249
Minimum pension liability	—	—	52,519
Other liabilities	189,010	127,955	149,403
Total liabilities	19,630,175	15,995,771	15,134,186
Commitments and contingencies (Note 17)			
Shareholders' Equity			
Perpetual preferred stock (Note 11)	150,000	150,000	150,000
Protected borrower equity	7,628	10,123	12,453
Capital stock and participation certificates	120,370	125,089	128,099
Retained earnings			
Allocated	925,919	849,626	792,168
Unallocated	1,943,444	1,861,476	1,587,934
Accumulated other comprehensive income (loss)	(2,976)	3,331	(108,923)
Total shareholders' equity	3,144,385	2,999,645	2,561,731
Total liabilities and shareholders' equity	$22,774,560	$18,995,416	$17,695,917

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, 2005	2004	2003
Interest Income			
Investment securities	$ 169,034	$ 74,757	$ 59,426
Loans	1,028,563	826,926	801,068
Other investments	1,677	—	—
Total interest income	1,199,274	901,683	860,494
Interest Expense	588,773	332,857	284,581
Net interest income	610,501	568,826	575,913
Provision for (reversal of) loan losses	(6,492)	(213,388)	8,153
Net interest income after provision for loan losses	616,993	782,214	567,760
Noninterest Income			
Loan fees	35,931	34,317	36,326
Fees for financially related services	6,347	6,544	6,249
Realized gains (losses) on investments, net	466	(17)	247
Gains (losses) on sale of rural home loans	2,935	(717)	523
Gain on sale of mortgage servicing assets	1,078	—	—
Other noninterest income	8,796	13,576	6,396
Total noninterest income	55,553	53,703	49,741
Noninterest Expenses			
Salaries and employee benefits	188,191	179,907	173,843
Occupancy and equipment	29,071	26,441	24,503
Insurance Fund premium	7,447	7,088	16,179
Other operating expenses	66,937	60,895	56,031
Intra-System financial assistance expenses	3,221	6,794	13,162
Restructuring charge	—	3,697	—
Called debt expense	656	3,360	11,736
Other noninterest expenses	1,978	2,161	1,557
Total noninterest expenses	297,501	290,343	297,011
Income before income taxes	375,045	545,574	320,490
Provision for income taxes (Note 12)	(2,132)	10,363	859
Net income	$ 377,177	$ 535,211	$ 319,631

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, 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, includes reclassification adjustments of $45						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 ($17)						1,859	1,859
Change in fair value of derivative instruments, includes reclassification adjustments of $96						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
Comprehensive income							
Net income					377,177		377,177
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $466						(12,944)	(12,944)
Change in fair value of derivative instruments, includes reclassification adjustments of $94						6,643	6,643
Minimum pension liability adjustment						(6)	(6)
Total comprehensive income							370,870
Protected borrower equity retired		(2,495)					(2,495)
Capital stock/participation certificates issued/retired, net			(5,030)				(5,030)
Dividends declared/paid			311		(3,311)		(3,000)
Perpetual preferred stock dividends paid					(10,950)		(10,950)
Patronage distribution							
Cash					(95,354)		(95,354)
Qualified allocated surplus				26,391	(26,391)		—
Nonqualified allocated surplus				83,420	(83,420)		—
Nonqualified retained surplus				73,653	(73,653)		—
Retained earnings retired				(109,254)			(109,254)
Patronage distribution adjustment				2,083	(2,130)		(47)
Balance at December 31, 2005	$ 150,000	$ 7,628	$ 120,370	$ 925,919	$ 1,943,444	$ (2,976)	$ 3,144,385

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, 2005	2004	2003
Cash flows from operating activities:			
Net income	$ 377,177	$ 535,211	$ 319,631
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	14,695	13,997	12,624
Provision for (reversal of) loan losses	(6,492)	(213,388)	8,153
(Gains) losses on other property owned, net	203	479	193
Realized (gains) losses on investments, net	(466)	17	(247)
Realized (gains) losses on derivatives, net	(94)	(96)	(45)
Realized (gains) losses on sale of servicing assets	(1,078)	—	—
Realized (gains) losses on mortgage loans held for sale	(2,935)	717	(523)
Proceeds from sale of mortgage loans held for sale	6,664	255,951	754,486
Purchases of mortgage loans held for sale (net of principal repayment)	(264,032)	(329,939)	(667,196)
Proceeds from sale of mortgage servicing assets	10,039	—	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(48,568)	(9,395)	9,631
(Increase) decrease in deferred tax assets, net	538	11,074	458
(Increase) decrease in other assets	(18,649)	(126,559)	1,302
Increase (decrease) in accrued interest and dividend payable	68,001	13,829	8,292
Increase (decrease) in postretirement benefits other than pensions	9,711	13,721	12,056
Increase (decrease) in minimum pension liability	—	(52,519)	(9,303)
Increase (decrease) in other liabilities	34,486	63,688	13,884
Total adjustments	(197,977)	(358,423)	143,765
Net cash provided by (used in) operating activities	179,200	176,788	463,396
Cash flows from investing activities:			
Investment securities purchased	(4,160,321)	(4,091,449)	(4,826,206)
Investment securities sold or matured	2,135,845	3,647,593	4,137,375
Net (increase) decrease in loans	(1,079,477)	(451,223)	(609,583)
(Increase) decrease in investments in other Farm Credit System institutions	(527)	10,928	(421)
Net (increase) decrease in other investments	(237,239)	—	—
Purchase of premises and equipment, net	(25,155)	(23,686)	(22,177)
Proceeds from sale of other property owned	3,717	2,855	6,966
Net cash used in investing activities	(3,363,157)	(904,982)	(1,314,046)
Cash flows from financing activities:			
Bonds and notes issued	38,071,784	41,613,349	57,612,100
Bonds and notes retired	(34,560,543)	(40,695,748)	(56,641,370)
Perpetual preferred stock issued	—	—	150,000
Protected borrower equity retired	(2,495)	(2,330)	(3,033)
Capital stock and participation certificates issued/retired, net	(5,030)	(3,070)	3,474
Patronage refunds and dividends paid	(81,587)	(66,435)	(64,420)
Dividends paid on perpetual preferred stock	(10,950)	(10,950)	(1,851)
Dividends paid on mandatorily redeemable preferred stock	—	—	(10,282)
Retained earnings retired	(109,254)	(111,010)	(111,175)
Net cash provided by financing activities	3,301,925	723,806	933,443
Net increase (decrease) in cash and cash equivalents	117,968	(4,388)	82,793
Cash and cash equivalents, beginning of period	522,862	527,250	444,457
Cash and cash equivalents, end of period	$ 640,830	$ 522,862	$ 527,250
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 1,284	$ 627	$ 671
Loans transferred to other property owned	5,417	5,141	4,817
Change in unrealized gains (losses) on investments	(12,944)	1,859	(9,480)
Change in fair value of derivative instruments	6,643	12,120	2,116
Change in pension liability related to other comprehensive income	(6)	98,275	9,096
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ 55	$ (344)	$ (1,894)
Increase (decrease) in bonds and notes	(33,662)	(22,225)	1,082
Decrease (increase) in other assets	(937)	2,359	(1,564)
Increase (decrease) in other liabilities	27,807	8,090	(3,107)
Supplemental information:			
Interest paid	$ 520,772	$ 319,028	$ 276,289
Taxes paid, net	1,350	1,772	2,716
Federal tax refunds related to long-term lending operations (Note 12)	—	816	901

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

Notes to Combined Financial Statements

Note 1 — Organization and Operations

A. **Organization:** AgFirst Farm Credit Bank (the Bank or AgFirst) is one of the banks of the Farm Credit System (the System), a nationwide system of cooperatively owned banks (the banks) and associations. Banks and associations are collectively referred to as a district (district). The System was 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) and one Agricultural Credit Bank (ACB), each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities. The Bank is chartered to service the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, the Commonwealth of Puerto Rico and portions of the states of Ohio, Tennessee, Kentucky and Louisiana.

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as associations. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The District Associations jointly own all of AgFirst's voting stock. As of December 31, 2005, the District consisted of the Bank and twenty-three District ACAs. All twenty-three are structured as holding companies, which include 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 the System banks and associations. The activities of the banks and associations are examined by the FCA and certain actions by these entities are subject to the FCA's prior approval.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund based on its average annual District loans outstanding until the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.00 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. 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, their cooperatives, 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 borrowed funds from the Bank and eligible funds from qualified companies doing business in Puerto Rico under Section 2(j) of the Puerto Rico Tax Incentive Act of 1987, as amended, or the Puerto Rico Tax Incentive Act of 1998, including corporations that had elections under Section 936 and 30(A) of the Internal Revenue Code of 1986, as amended (Code). The funds so borrowed were 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 were, in part, passed along to borrowers in Puerto Rico who met certain eligibility requirements.

The operations of the Finance Corporation were suspended effective December 31, 2005. The Board of Directors of the Finance Corporation determined there was insufficient financial benefit resulting from island-based tax treatment of the corporation to justify continuing the operations of the corporation at this time. All outstanding capital of the Finance Corporation was transferred to AgFirst on December 31, 2005. This will not have a material effect on the financial condition of the AgFirst District.

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 and Associations have 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, managing interest rate risk and, in the case of certain Mission-Related Investments, to stimulate economic growth and development in rural areas. Investments are classified based on management's intention on the date of purchase and recorded on the Combined Balance Sheet as securities as of the trade date. Investment securities which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Investment securities classified as available-for sale (AFS) are carried at fair market value with net unrealized gains and losses included in Accumulated Other Comprehensive Income (OCI).

   Interest on investment securities, including amortization of premiums and accretion of discounts, are included in Interest Income. Realized gains and losses from the sales of investment securities, which are included in Realized Gains/ (Losses) on Investments, Net, are determined using the specific identification method.

   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 other than temporary. In the event of other-than-temporary impairment, the cost basis of the investment would be written down to its fair value, and the unrealized 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 Statement of Financial Accounting Standards (SFAS) No. 133 valuation adjustments. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) and/or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, the interest portion of payments received in cash is generally recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan asset. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

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 Investments:** Other Investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC) which qualify as Mission-Related Investments under FCA regulations. Under the SIIC, the Tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.

E. **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.

F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. 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.

G. **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.

H. **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 outstanding gross balances of advance conditional payments netted against loans at December 31, 2005, 2004 and 2003 were $212.9 million, $165.5 million and $133.5 million, respectively. The outstanding gross balances of advance conditional payments classified as other liabilities at December 31, 2005, 2004 and 2003 were $23.7 million, $13.1 million and $20.8 million, respectively.

I. **Employee Benefit Plans:** The employees of the District may be eligible to participate in one of three defined benefit retirement plans within the District. The "Projected Unit Credit" actuarial method is used for financial reporting 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 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Generally, Thrift Plan costs are expensed as funded.

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

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

J. **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 received a credit for taxes payable on Puerto Rico sourced income in accordance with Section 936 of the Internal Revenue Code of 1986, as amended. However, the Section 936 noted was terminated effective December 31, 2005. See Note 1(B) — *Operations*.

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, 2005, deferred income taxes had 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.

K. **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.

L. **Valuation Methodologies:** Management of the District applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets, such as most investment securities. However, for those items for which an observable liquid market does not exist, management utilizes significant estimates and assumptions to value those items. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain derivative and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the District's results of operations.

M. **Recent Accounting Developments:** In May 2003, the Financial Accounting Standards Board (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 $225.0 million was reclassified to liabilities and the related dividends paid on that stock are treated as interest expense beginning July 1, 2003 rather than as a direct reduction of unallocated surplus. See Note 10 for further discussion.

In November 2005, the Financial Accounting Standards Board released, FSP Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. This FASB Staff Position (FSP) addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and nullifies certain guidance in Emerging Issues Task Force (EITF) Issue 03-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. The guidance in this FSP shall be applied to reporting periods beginning after December 15, 2005.

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 methodology was adjusted and revised in the late 1980s to take into account unusually adverse economic factors affecting American agriculture. Subsequent estimates continued to reflect, to some extent, the loss history of the mid-to-late 1980s. Accordingly, the reserves provided in the mid-to-late 1980s, in effect, remained part of the allowance for loan losses.

The District's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of probable losses, economic conditions and historical loss experience keeping in mind the potentially long agricultural credit cycle.

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 $215.4 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 $3.10 billion at December 31, 2004 (20.86 percent of District loans), as compared with $2.88 billion at December 31, 2003 (20.08 percent of District loans).

Note 4 — Investment Securities

Available-for-Sale

A summary of the amortized cost and fair value of debt securities held as available-for-sale investments at December 31, 2005, 2004 and 2003, follows:

	December 31, 2005				
(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Yield**
Commercial Paper	$ 69,813	$ –	$ (17)	$ 69,796	4.37%
U.S. Govt. GNMA MBS/CMOs	1,060,168	1,779	(5,664)	1,056,283	4.39
U.S. Govt. Agency MBS	2,029,368	5,714	(5,121)	2,029,961	4.50
Non-agency whole loans	596,956	899	(185)	597,670	4.74
Commercial MBS	–	–	–	–	–
Asset backed securities	132,584	31	(7)	132,608	5.43
Total	$ 3,888,889	$ 8,423	$ (10,994)	$ 3,886,318	4.54%

	December 31, 2004				
(dollars in thousands)	**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	292,537	9	(1)	292,545	2.68
Commercial MBS	–	–	–	–	–
Asset backed securities	21,926	3	(8)	21,921	2.60
Total	$ 3,268,041	$ 13,779	$ (3,406)	$ 3,278,414	2.80%

	December 31, 2003				
(dollars in thousands)	**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%

Held-to-Maturity

A summary of the amortized cost and fair value of debt securities held as held-to-maturity investments at December 31, 2005 and 2004 follows:

	December 31, 2005				
(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Yield**
U.S. Govt. Agency MBS	$ 1,379,203	$ 111	$ (31,700)	$ 1,347,614	5.31%
Commercial MBS	2,762	5	–	2,767	4.86
Asset-backed securities	34,682	161	(834)	34,009	7.00
Total	$ 1,416,647	$ 277	$ (32,534)	$ 1,384,390	5.35%

	December 31, 2004				
(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Yield**
U.S. Govt. Agency MBS	$ 12,553	$ 263	$ –	$ 12,816	5.79%
Total	$ 12,553	$ 263	$ –	$ 12,816	5.79%

AgFirst's and certain District Association'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 at December 31, 2005. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. AgFirst and certain District Associations have both the ability and the intent to recover substantially all of the cost in these investments.

	Less than 12 Months		Greater than 12 Months	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Commercial Paper	$ 69,796	$ 17	$ –	$ –
U.S. Govt. GNMA MBS/CMOs	368,795	3,224	59,876	2,439
U.S. Govt. Agency MBS	1,743,873	35,245	104,967	1,577
Non-Agency whole loans	103,152	185	–	–
Asset-backed securities	40,349	841	–	–
Total	$ 2,325,965	$ 39,512	$ 164,843	$ 4,016

On December 31, 2005, AgFirst held certain investments having continuous unrealized loss positions for more than 12 months with a fair value totaling $164.8 million and an unrealized loss position totaling $4.0 million. Substantially all of these investments were in U. S. Government Agency securities and AgFirst expects 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 AgFirst has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, AgFirst has not recognized any other-than-temporary impairment in connection with these investments.

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2005, follows:

Available-for-sale:

(dollars in thousands)	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ 69,813	$ 69,796	4.37%
After one year through five years	20,869	20,614	4.65
After five years through ten years	7,018	7,028	4.89
After ten years	3,791,189	3,788,880	4.54
Total	$ 3,888,889	$ 3,886,318	4.54%

Held-to-maturity:

(dollars in thousands)	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ 82	$ 82	7.12%
After one year through five years	7,704	7,619	6.97
After five years through ten years	11,364	11,127	6.91
After ten years	1,397,497	1,365,562	5.33
Total	$ 1,416,647	$ 1,384,390	5.35%

Included in the available-for-sale investments are collateralized mortgage obligations. 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,		
(dollars in thousands)	2005	2004	2003
Proceeds on sales	$ 383,676	$ 197,340	$ 69,242
Realized gains	908	6	247
Realized losses	442	23	–

Note 5 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
(dollars in thousands)	2005	2004	2003*
Production agriculture:			
Real estate mortgage	$ 7,401,816	$ 6,890,364	$ 6,315,505
Production and intermediate-term	6,378,740	5,868,713	5,412,454
Agribusiness:			
Loans to cooperatives	164,776	137,474	396,000
Processing and marketing	682,709	603,081	268,113
Farm-related business	369,574	336,434	201,181
Communication	33,423	85,269	166,858
Energy	156,006	176,397	234,677
Rural residential real estate	959,353	720,740	800,123
Lease receivables	22,525	15,906	3,413
Discounted loans to OFIs	2,650	1,900	500
Other	–	–	537,955
Total	$ 16,171,572	$ 14,836,278	$ 14,336,779

* *Beginning with year-end 2004, loan type categories have been expanded to provide additional information on the types of loans made. As a result, 2003 would reflect old loan types.*

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	2005	2004	2003
Poultry	13%	12%	12%
Forestry	12	11	10
Cattle	8	8	8
Grain	7	7	7
Rural home	7	5	5
Dairy	6	7	7
Nursery/Greenhouse	5	5	5
Lumber/Paper	3	4	3
Swine	3	3	4
Tobacco	3	3	3
Cotton	3	3	3
Citrus	2	2	3
Utilities	1	2	3
Other	27	28	27
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,		
(dollars in thousands)	2005	2004	2003
Nonaccrual:			
Current as to principal and interest	$ 51,830	$ 59,967	$ 42,448
Past due	30,982	41,782	78,618
Accrual:			
Restructured	3,151	3,556	4,328
90 days or more past due	2,353	2,034	2,804
Total impaired loans	$ 88,316	$ 107,339	$ 128,198

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2005.

The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
(dollars in thousands)	2005	2004	2003
Interest income recognized on nonaccrual loans	$ 8,802	$ 9,826	$ 11,520
Interest income on impaired accrual loans	727	1,543	1,434
Interest income recognized on impaired loans	$ 9,529	$ 11,369	$ 12,954

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

(dollars in thousands)	2005	2004	2003
Impaired loans with related allowance	$ 38,326	$ 39,597	$ 42,695
Impaired loans with no related allowance	49,990	67,742	85,503
Total impaired loans	$ 88,316	$ 107,339	$ 128,198
Average impaired loans	$ 93,917	$ 120,899	$ 131,837
Allowance on impaired loans	$ 20,642	$ 26,473	$ 20,667

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

	Year Ended December 31,		
(dollars in thousands)	2005	2004	2003
Balance at beginning of year	$ 95,419	$ 316,735	$ 311,180
Provision for (reversal of) loan losses	(6,492)	2,037	8,153
Reversal of provision due to change in methodology	–	(215,425)	–
Loans charged off	(2,615)	(9,887)	(5,885)
Recoveries	1,239	1,959	3,287
Balance at end of year	$ 87,551	$ 95,419	$ 316,735

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 $825.6 million, $662.1 million and $564.1 million at December 31, 2005, 2004 and 2003, respectively. Fees paid to Farmer Mac for such commitments totaled $2.3 million, $2.6 million and $2.2 million for the years ended December 31, 2005, 2004 and 2003, respectively. Fees paid to government sponsored enterprises (GSEs) other than Farmer Mac were $581 thousand, $628 thousand and $96 thousand for 2005, 2004 and 2003, respectively. These amounts are classified as noninterest expense.

Note 6 — Other Investments

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004". The Tobacco Act repealed the Federal tobacco price support and quota programs, provides for payments to tobacco "quota owners" and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2005, the USDA issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout).

The FCA determined that System institutions are "financial institutions" within the meaning of the Tobacco Act and are, therefore, eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA's goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities. As of December 31, 2005, eleven District Associations held investments in Tobacco Buyout SIICs of $237.2 million.

Note 7 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
(dollars in thousands)	2005	2004	2003
Land	$ 19,399	$ 17,938	$ 12,715
Buildings and improvements	77,977	70,483	70,464
Furniture and equipment	92,152	84,891	72,462
Work in progress	9,919	10,553	10,442
	199,447	183,865	166,083
Less: accumulated depreciation	92,384	87,262	79,169
Total	$ 107,063	$ 96,603	$ 86,914

Note 8 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

(dollars in thousands)	December 31, 2005	2004	2003
Other assets:			
Prepaid pension costs	$ 141,580	$ 133,774	$ 8,942
Derivative assets	2,066	1,125	3,484
Unamortized debt issue costs	12,038	9,054	9,109
Deferred preferred stock costs	2,701	3,385	3,974
Intangible asset related to pension	–	–	1,728
Prepaid expenses	3,145	3,265	760
Receivables and other	46,849	48,229	44,276
Total	$ 208,379	$ 198,832	$ 72,273
Other liabilities:			
Accounts payable	$ 23,444	$ 24,221	$ 23,361
Derivative liabilities	39,100	11,278	3,188
Farm Credit System Ins. Corp. payable	7,475	7,057	16,171
Bank draft payable	55,628	38,574	54,059
Payroll	20,733	19,016	19,457
Short-term funds held	23,749	13,134	20,756
Nonqualified pension liability	7,126	6,140	–
Other	11,755	8,535	12,411
Total	$ 189,010	$ 127,955	$ 149,403

Note 9 — 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, 2005, 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.

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

	Bonds		Medium-Term Notes		Discount Notes		Total	
Maturities	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
			(dollars in thousands)					
2006	$ 5,546,432	3.48%	$ –	–%	$ 1,726,225	3.87%	$ 7,272,657	3.57%
2007	4,709,288	3.89	15,202	6.75	–	–	4,724,490	3.89
2008	2,026,642	3.79	–	–	–	–	2,026,642	3.79
2009	1,643,669	4.23	–	–	–	–	1,643,669	4.23
2010	915,029	4.42	–	–	–	–	915,029	4.42
2011	2,297,477	5.18	–	–	–	–	2,297,477	5.18
Total	$ 17,138,537	3.98%	$ 15,202	6.75%	$ 1,726,225	3.87%	$ 18,879,964	3.97%

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, 2005, was 32 days.

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

Amount	First Call Date	Year of Maturity
(dollars in thousands)		
$ 8,152,000	2006	2006-2019
256,000	2007	2009-2012
13,000	2008	2015-2020
2,000	2010	2012
$ 8,423,000		

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 and not designated for specific use. All other liabilities on the financial statements are uninsured. At December 31, 2005 the assets of the Insurance Fund aggregated $2.06 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund were used in June 2005 to repay the Financial Assistance Corporation debt issued to fund the purchase of $374 million of Federal Land Bank of Jackson preferred stock.

Note 10 — Mandatorily Redeemable Preferred Stock

As of December 31, 2005, AgFirst had 225 thousand shares issued and outstanding of Mandatorily Redeemable Cumulative Preferred Stock at a par value of $1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable semi-annually in arrears on the 15th day of June and December of each year at an annual rate equal to 8.393 percent of the $1 thousand per share par value. 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 11 — 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 thousand 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 2.00 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, 2005:

		Shares Outstanding (dollars in thousands)	
Class	Protected Status	Number	Aggregate Par Value
A Common Nonvoting	Yes	142,000	$ 710
A Common Nonvoting	No	–	–
B Common Nonvoting	Yes	1,286,000	6,430
B Common Nonvoting	No	–	–
B Common Voting	No	–	–
C Common Voting	No	17,524,800	87,624
B Participation Certificates	Yes	97,600	488
C Participation Certificates	No	1,741,600	8,708
Participation Certificates	No	–	–
A Preferred	No	3,240,600	16,203
C Preferred	No	143,000	715
Total Association Capital Stock and Participation Certificates		24,175,600	$ 120,878

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, 2005, combined allocated retained earnings consisted of $376.4 million of qualified surplus, $281.2 million of nonqualified allocated surplus and $268.3 million 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 $7.0 million 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, 2005, AgFirst had $81 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, 2005.

	Permanent Capital Ratio Ranges	Core Surplus Ratio Ranges	Total Surplus Ratio Ranges
AgFirst	23.90%	14.15%	23.84%
District Associations	12.54% – 24.02%	9.60% – 23.59%	11.28% – 23.59%

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 104.00 percent compared to the regulatory minimum of 103.00 percent. At December 31, 2005, AgFirst's net collateral ratio was 105.70 percent.

Included in the above table as of December 31, 2005, are all twenty-three 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, 2005.

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.

An additional component of retained earnings is accumulated other comprehensive income/loss, which is reported net of taxes as follows:

(dollars in thousands)	2005	2004	2003
Unrealized (losses) gains on investments available-for-sale	$ (2,571)	$ 10,373	$ 8,514
Unrealized (losses) on cash flow hedges	–	(6,643)	(18,763)
Minimum pension liability adjustment	(405)	(399)	(98,674)
	$ (2,976)	$ 3,331	$(108,923)

Note 12 — Income Taxes

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

	Year Ended December 31,		
(dollars in thousands)	2005	2004	2003
Current:			
Federal	$ (2,203)	$ 116	$ 1,960
State	(467)	527	248
ACA tax refunds	–	(1,159)	(901)
	(2,670)	(516)	1,307
Deferred:			
Federal	320	6,530	(230)
State	218	1,382	(218)
Write-off deferred tax assets	–	2,967	–
	538	10,879	(448)
Total provision (benefit) for income taxes	$ (2,132)	$ 10,363	$ 859

In connection with the reversal of the allowance for loan losses due to the refinement of methodologies, $11.2 million 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 thousand and $901 thousand in 2004 and 2003, respectively, which is included as a component of the 2004 and 2003 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,		
(dollars in thousands)	2005	2004	2003
Federal tax at statutory rate	$127,418	$ 185,495	$ 109,038
State tax, net	(249)	1,126	341
Tax-exempt FLCA earnings	(78,471)	(91,370)	(48,942)
Association patronage distributions	(40,273)	(43,364)	(33,353)
Nontaxable Bank income	(11,258)	(18,230)	(31,015)
Possessions credit (Puerto Rico)	(594)	(785)	(511)
ACA tax refunds	–	(1,489)	(901)
Write-off of deferred tax assets	–	2,967	–
Allowance for loan loss reversal	–	(26,154)	–
Other	1,295	2,167	6,202
Provision for income taxes	$ (2,132)	$ 10,363	$ 859

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

	December 31,		
(dollars in thousands)	2005	2004	2003
Allowance for loan losses	$ 18,533	$ 10,671	$ 21,971
Annual leave	–	169	158
Nonaccrual loan interest	2,235	1,359	1,164
Postretirement benefits other than pensions	7,846	1,106	1,087
Nonqualified patronage distributions	6,318	29,987	15,875
Loss carryforwards	5,420	–	–
Other	1,666	4,310	5,344
Gross deferred tax asset	42,018	47,602	45,599
Deferred tax asset valuation allowance	(18,772)	(21,350)	(18,142)
Future Bank stock redemptions	–	(2,787)	(4,684)
Bank patronage	(9,256)	(4,315)	(2,909)
State income tax	–	(653)	(1,087)
Loan fees	–	(1,444)	(1,694)
Pensions	(8,877)	(1,090)	(995)
Depreciation	(261)	(134)	(101)
Other	(3,161)	(13,600)	(2,684)
Gross deferred tax liability	(21,555)	(24,023)	(14,154)
Net deferred tax asset	$ 1,691	$ 2,229	$ 13,303

At December 31, 2005, 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 13 — Employee Benefit Plans

The employees of the District may participate in one of three defined benefit retirement plans. The first plan (the District Plan) covers most 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. 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:

(dollars in thousands)	PENSION BENEFITS As of December 31, 2005	2004	2003
Change in benefit obligation			
Benefit obligation at beginning of year	$ 442,887	$ 372,158	$ 324,397
Service cost	13,517	13,937	11,159
Interest cost	26,141	22,888	21,268
Actuarial loss (gain)	58,688	43,502	30,744
Benefits paid	(17,325)	(16,753)	(14,973)
Other	7,102	7,155	(437)
Benefit obligation at end of year	$ 531,010	$ 442,887	$ 372,158
Change in plan assets			
Fair value of plan assets at beginning of year	$ 381,577	$ 258,673	$ 214,702
Actual return on plan assets	51,962	33,212	41,407
Employer contributions	28,439	106,618	17,537
Transfers	(272)	(173)	–
Benefits and premiums paid	(17,325)	(16,753)	(14,973)
Fair value of plan assets at end of year	$ 444,381	$ 381,577	$ 258,673
Funded Status	$ (86,629)	$ (61,310)	$ (113,485)
Unrecognized net actuarial loss (gain)	214,039	186,610	167,951
Unamortized prior service cost	9,018	3,946	3,722
Unrecognized net (asset) or obligation	(578)	(917)	(1,364)
Net amount recognized	$ 135,850	$ 128,329	$ 56,824
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ 141,580	$ 133,774	$ 8,942
Accrued benefit liability	(6,593)	(5,843)	(52,519)
Intangible asset	459	–	1,728
Accumulated other comprehensive income	404	398	98,673
Net amount recognized	$ 135,850	$ 128,329	$ 56,824
Components of net periodic benefit cost			
Service cost	$ 13,517	$ 13,937	$ 11,159
Interest cost	26,141	22,888	21,268
Expected return on plan assets	(31,673)	(23,278)	(18,857)
Amortization of net (gain) loss	(338)	(338)	(338)
Amortization of prior service cost	634	839	648
Recognized net actuarial (gain) loss	12,515	9,190	9,558
FAS 88 – special termination benefits	–	1,552	–
Other	123	286	–
Net periodic benefit cost	$ 20,919	$ 25,076	$ 23,438

The FAS 88 – special termination benefits in 2004 were related to the merger of two Associations.

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 certain key employees is included in other liabilities on the combined balance sheets. During 2004, the District entities funded $106.6 million into the pension plans, eliminating the minimum pension liability. During 2005, the District entities funded an additional $28.4 million into the pension plans. The District had prepaid pension costs of $141.6 million included in other assets on the combined balance sheets as of December 31, 2005.

(dollars in thousands)	As of December 31, 2005	2004	2003
Aggregate PBO > FV plan assets			
Projected benefit obligation	$ 531,010	$ 442,887	$ 372,158
Fair value of plan assets	444,381	381,577	258,673
Aggregate ABO > FV plan assets			
Accumulated benefit obligation	$ 6,664	$ 5,729	$ 271,507
Fair value of plan assets	–	–	218,989
Additional Information			
Increase/decrease in minimum liability included in other comprehensive income	$ 6	$ 98,313	$ (9,379)

	As of December 31, 2005	2004	2003
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	5.25%	6.00%	6.25%
Rate of compensation increase	4.48%	4.47%	4.46%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.00%	6.25%	6.25%
Expected return on plan assets	8.46%	8.92%	8.88%
Rate of compensation increase	4.55%	4.54%	4.46%

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 45.00 percent U.S. equity, 20.00 percent non-U.S. equity, 5.00 percent real estate, and 30.00 percent fixed income. The plan's strategic asset allocation was determined by the Benefits Committee after review and evaluation of an asset/liability study.

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	2005	2004	2003
Asset Category			
Equity securities	65.1%	67.1%	70.2%
Debt securities	30.1	28.3	29.1
Real Estate	4.1	3.9	–
Other	.7	.7	.7
	100.0%	100.0%	100.0%

Target allocation for asset categories for 2006 are as follows:

Asset Category	
Equity securities	62.8% – 67.3%
Debt securities	28.2% – 32.7%
Real Estate	2.8% – 6.4%

The District expects to contribute $1.7 million to its defined benefit and supplemental retirement plans during 2006.

Projected benefit payouts are as follows:

	(dollars in thousands)
2006	$ 20,895
2007	21,948
2008	23,485
2009	25,509
2010	27,752
2011-2015	175,707

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 6.00 percent for government bonds plus an additional 0.50 percent due to the exposure of corporate debt in an aggregate benchmark, for a total return of 6.50 percent. A 3.00 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 certain key 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 $959 thousand, $956 thousand and $219 thousand for the years ended December 31, 2005, 2004 and 2003, 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 $0.50 for each $1.00 of the employee's contribution up to the maximum employer contribution of 3.00 percent of total compensation. For employees hired on or after January 1, 2003, the Bank and Associations will contribute $1.00 for each $1.00 of the employee's contribution up to the maximum employer contribution of 6.00 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 $4.2 million, $3.9 million and $3.6 million for 2005, 2004 and 2003, respectively.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401 (k) Employee Benefit Plan.

In addition to providing pension benefits, the Bank and District Associations provide 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 Associations.

The following is a table of other postretirement benefits expenses:

	OTHER POSTRETIREMENT BENEFITS As of December 31,		
(dollars in thousands)	**2005**	**2004**	**2003**
Change in benefit obligation			
Benefit obligation at beginning of year	$ 145,903	$ 150,152	$ 137,442
Service cost	2,908	3,719	3,633
Interest cost	8,574	9,272	9,089
Plan participant contributions	1,348	767	–
Actuarial loss (gain)	9,081	(12,505)	5,637
Benefits paid	(5,957)	(5,329)	(5,419)
Plan amendments/other	(35,809)	(173)	–
Benefit obligation at end of year	$ 126,048	$ 145,903	$ 150,382
Change in plan assets			
Fair value of plan assets at beginning of year	$ –	$ –	$ 194
Actual return on plan assets	–	–	–
Plan participant contributions	1,348	767	–
Employer contributions	4,609	4,562	5,225
Benefits and premiums paid	(5,957)	(5,329)	(5,419)
Fair value of plan assets at end of year	$ –	$ –	$ –
Funded Status	$ (126,048)	$ (145,903)	$ (150,382)
Unrecognized net actuarial loss (gain)	47,088	40,028	56,172
Unrecognized prior service cost	(24,730)	(1,932)	(1,629)
Unrecognized net (asset) or obligation	1,009	14,837	16,590
Net amount recognized	$ (102,681)	$ (92,970)	$ (79,249)
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ –	$ –	$ –
Accrued benefit liability	(102,681)	(92,970)	(79,249)
Intangible asset	–	–	–
Accumulated other comprehensive	–	–	–
Net amount recognized	$ (102,681)	$ (92,970)	$ (79,249)
Components of net periodic postretirement benefit costs			
Service cost	$ 2,908	$ 3,719	$ 3,633
Interest cost	8,574	9,272	9,089
Expected return on plan assets	–	–	(5)
Amortization of net (gain) loss	1,786	1,786	1,790
Amortization of prior service cost	(281)	(184)	(93)
Recognized net actuarial (gain) loss	2,021	3,353	2,965
Net periodic benefit (income) cost	$ 15,008	$ 17,946	$ 17,379
EXPECTED FUTURE CASH FLOWS			
Expected contributions			
Fiscal 2006	$ 5,164		
Expected benefit payments (net of employee contributions)			
Fiscal 2006	$ 5,164		
Fiscal 2007	5,510		
Fiscal 2008	5,903		
Fiscal 2009	6,423		
Fiscal 2010	6,931		
Fiscal 2011-2015	40,836		
Expected Medicare Part D reimbursements			
Fiscal 2006	$ –		
Fiscal 2007	10		
Fiscal 2008	11		
Fiscal 2009	12		
Fiscal 2010	13		
Fiscal 2011-2015	87		
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	5.25%	6.00%	6.25%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.00%	6.25%	6.75%
Expected return on plan assets	N/A	N/A	N/A
Assumed health care cost trend rates:			
Health care cost trend rate assumed for next year	7.0%–9.50%	9.75%	10%–12%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.75%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2015	2012	2013

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:

(dollars in thousands)	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost	$ 2,027	$ (1,622)
Effect on postretirement benefit obligation	18,024	(14,822)

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). The benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act.

In determining the benefit obligation as of December, 31, 2004, the expected per capita claims cost were estimated to be reduced by 12.00 percent beginning in 2006, for Medicare-eligible participants receiving actuarially equivalent drug benefits, due to a government reimbursement of a portion of prescription drug benefits. The District reduced its accumulated postretirement benefit obligation (APBO) for the subsidy related to benefits attributed to past service. The effect of the subsidy on the measurement of net periodic postretirement cost for 2005 was a reduction of 2005 expense. The effect included lower amortization of actuarial losses, lower service costs and lower interest costs on the APBO.

The Retiree and Disabled Medical Plan was amended effective January 1, 2006 to change the medical and prescription drug coverage for Medicare-eligible retirees and/or eligible spouses 65 years and older. Beginning in 2006, the AgFirst/FCBT Retiree and Disabled Medical Plan will provide medical and prescription drug coverage to Medicare-eligible retirees and/or eligible spouses 65 years and older through fully-insured AARP endorsed Medicare Supplement policies and subsidized basic Medicare D coverage through a selected Prescription Drug Plan. Dental coverage was not changed. Retirees of the Puerto Farm Credit Association and certain other retirees who are grandfathered under insured arrangements were not impacted by the change. The benefit obligation valuation as of December 31, 2005 reflects the impact of this plan amendment.

In determining the benefit obligation as of December 31, 2005, there was no impact due to government reimbursement of prescription drug benefits, except for Medicare-eligible and/or eligible spouses of the Puerto Rico Farm Credit Association. After the plan amendment, the plan no longer provides prescription drug benefits directly for retirees and/or eligible spouses 65 years and older. Instead, the District subsidizes the cost of coverage obtained under the Medicare D program through the selected Prescription Drug Provider.

Note 14 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Farm Credit System Financial Assistance Corporation, (Financial Assistance Corporation) of U.S. Treasury-guaranteed 15-year bonds, of which $1.26 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

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 required that banks pay 100.00 percent of the interest beginning in 1999.

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 was repaid by System banks in June 2005. System banks recorded 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 were 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 District's financial assistance expense totaled $3.2 million, $6.8 million, and $13.2 million in 2005, 2004, and 2003, respectively.

Note 15 — 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, 2005, amounted to $257.5 million, as compared with $ 235.3 million and $226.2 million for the years ended December 31, 2004 and 2003, respectively. During 2005, 2004 and 2003, $369.1 million, $230.0 million and $232.3 million of new loans were made and repayments totaled $347.0 million, $220.9 million and $199.3 million, respectively. In the opinion of management, no material amounts outstanding at December 31, 2005, involved more than a normal risk of collectibility.

Note 16 — Regulatory Enforcement Matters

At December 31, 2005, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 17 — 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, 2005 were $112.70 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, 2005, the Bank had $76.7 million in letters of credit with non-District entities with $8.4 million expiring in less than one year, $14.7 million due to expire in one to three, $47.5 million expiring in five years and the remaining $6.1 million have terms that will expire from 2011 to 2016. As of December 31, 2005, the District Associations had $74.7 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, 2005.

At December 31, 2005, $4.40 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, 2005, AgFirst also indemnifies leases in the amount of $3.0 million on behalf of Farm Credit Leasing Services Corporation (FCLSC) with lease terms expiring in 2009.

As of December 31, 2005, the District Associations had commitments to purchase $112.7 million in additional Tobacco Buyout SIIC in 2006.

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 18 — 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, 2005, 2004 and 2003. 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, 2005		December 31, 2004		December 31, 2003	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$16,171,572	$16,154,949	$14,836,278	$15,130,575	$14,336,779	$14,639,396
Allowance for loan losses	(87,551)	–	(95,419)	–	(316,735)	–
Loans, net	$16,084,021	$16,154,949	$14,740,859	$15,130,575	$14,020,044	$14,639,396
Derivative assets	$ 2,066	$ 2,066	$ 1,125	$ 1,125	$ 3,484	$ 3,484
Cash & cash equivalents	$ 640,830	$ 640,830	$ 522,862	$ 522,862	$ 527,250	$ 527,250
Investment securities	$ 5,302,965	$ 5,270,708	$ 3,290,967	$ 3,291,230	$ 2,832,716	$ 2,832,716
Other investments	$ 237,239	$ 234,391	$ –	$ –	$ –	$ –
Financial liabilities:						
Systemwide Debt Securities	$18,879,964	$18,753,747	$15,402,385	$15,206,435	$14,507,105	$14,475,670
Financial assistance related liabilities	$ –	$ –	$ (1,322)	$ (609)	$ 78	$ 2,660
Derivative liabilities	$ 39,100	$ 39,100	$ 11,278	$ 11,278	$ 3,188	$ 3,188

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. **Other Investments:** Fair value is estimated by discounting future annual cash flows using prevailing rates for similar instruments at year-end.

E. **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.

F. **Financial Assistance Related Liabilities:** As discussed in Note 14, the District was liable for certain obligations of the Financial Assistance Corporation. Fair value of these obligations was 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.

G. **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.

H. **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 19 — 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. The estimated credit risk exposure of $2.1 million with eight counterparties represents approximately 0.07 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, 2005, 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 20 — 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.

	Maturities of 2005 Derivative Products and Other Financial Instruments							
December 31, 2005 *(dollars in millions)*	**2006**	**2007**	**2008**	**2009**	**2010**	**After 2011**	**Total**	**Fair Value**
Systemwide Debt Securities:								
Fixed rate	$ 4,631	$ 2,269	$ 1,713	$ 1,452	$ 815	$ 2,297	$ 13,177	$ 13,006
Weighted average interest rate	3.20%	3.52%	3.70%	4.21%	4.44%	5.18%	4.04%	
Variable rate	2,657	2,440	313	191	100	2	5,703	5,747
Weighted average interest rate	4.24%	4.24%	4.32%	4.31%	4.28%	4.23%	4.27%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 615	$ 350	$ 415	$ 450	$ –	$ 100	$ 1,930	$ (37)
Weighted average receive rate	2.55%	2.99%	3.57%	4.03%	–	5.01%	3.32%	
Weighted average pay rate	4.60%	4.55%	4.63%	4.68%	–	4.67%	4.62%	
Amortizing pay fixed								
Notional value	–	–	–	–	–	440	440	–
Weighted average receive rate	–	–	–	–	–	4.81%	4.81%	
Weighted average pay rate	–	–	–	–	–	4.95%	4.95%	
Amortizing floating for floating swaps								
Notional value	264	–	–	–	–	–	264	–
Weighted average receive rate	3.20%	–	–	–	–	–	3.20%	
Weighted average pay rate	3.02%	–	–	–	–	–	3.02%	
Interest rate caps								
Notional value	239	–	–	–	–	–	239	–
Total notional value	$ 1,118	$ 350	$ 415	$ 450	$ –	$ 540	$ 2,873	$ (37)
Total weighted average rates on swaps:								
Receive rate	2.74%	2.99%	3.57%	4.03%	–	4.85%	–	3.56%
Pay rate	4.12%	4.55%	4.63%	4.68%	–	4.90%	–	4.51%

Note 21 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2005, 2004 and 2003 follow:

	2005				
(dollars in thousands)	First	Second	Third	Fourth	Total
Net interest income	$ 144,555	$ 150,859	$ 156,310	$ 158,777	$ 610,501
Provision for (reversal of) loan losses	(1,265)	283	(349)	(5,161)	(6,492)
Noninterest income (expense), net	(57,127)	(55,464)	(60,333)	(69,024)	(241,948)
(Provision) benefit for income taxes	(70)	(186)	196	2,192	2,132
Net income	$ 88,623	$ 94,926	$ 96,522	$ 97,106	$ 377,177

	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 (reversal of) 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

Note 22 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

	December 31,		
(dollars in thousands)	2005	2004	2003
Cash, cash equivalents and investment securities	$ 5,813,627	$ 3,748,672	$ 3,302,661
Loans			
To District Associations	12,441,170	11,229,197	10,592,325
To others	1,969,880	1,679,052	1,783,026
Total loans	14,411,050	12,908,249	12,375,351
Less: allowance for loan losses	10,114	14,800	34,168
Net loans	14,400,936	12,893,449	12,341,183
Other assets	268,468	245,402	235,704
Total assets	$ 20,483,031	$ 16,887,523	$ 15,879,548
Bonds and notes	$ 18,879,964	$ 15,402,385	$ 14,507,105
Mandatorily redeemable preferred stock	225,000	225,000	225,000
Other liabilities	340,639	235,842	192,911
Total liabilities	19,445,603	15,863,227	14,925,016
Perpetual preferred stock	150,000	150,000	150,000
Capital stock and participation certificates	224,554	226,200	229,083
Retained earnings	665,445	644,366	601,699
Accumulated other comprehensive income (loss)	(2,571)	3,730	(26,250)
Total shareholders' equity	1,037,428	1,024,296	954,532
Total liabilities and equity	$ 20,483,031	$ 16,887,523	$ 15,879,548

Statement of Income

	Year Ended December 31,		
(dollars in thousands)	2005	2004	2003
Interest income	$ 792,673	$ 544,339	$ 528,549
Interest expense	588,472	332,744	284,492
Net interest income	204,201	211,595	244,057
Provision for (reversal of) loan losses	(4,995)	(15,292)	2,500
Net interest income after provision for loan losses	209,196	226,887	241,557
Noninterest income	16,749	18,021	9,513
Noninterest expenses			
Salaries and employee benefits	27,957	26,172	23,367
Occupancy and equipment	11,108	9,823	8,552
Insurance Fund premium	884	845	2,014
Other operating expenses	15,882	15,448	13,088
Intra-System financial assistance expenses	3,221	6,794	13,308
Called debt expense	656	3,360	11,736
Other expenses	1,978	2,160	1,556
Total noninterest expenses	61,686	64,602	73,621
Net income	$ 164,259	$ 180,306	$ 177,449