growth

GROWTH

through innovation, accountability, value

AgFirst Farm Credit Bank | 2001 Annual Report

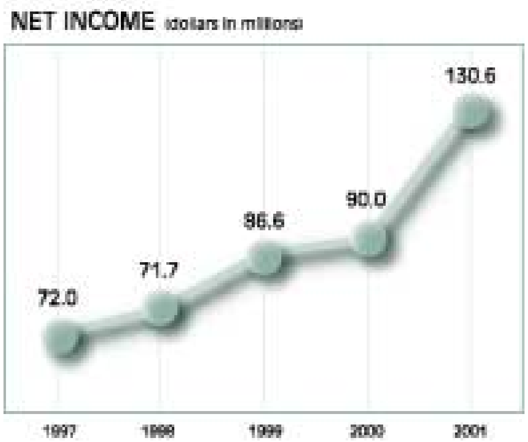
financial highlights

FINANCIAL HIGHLIGHTS

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA (UNAUDITED)

	December 31,				
(dollars in thousands)	**2001**	2000	1999	1998	1997
Consolidated Balance Sheet Data					
Cash and cash equivalents	**$ 265,254**	$ 241,588	$ 342,874	$ 306,914	$ 199,446
Investment securities	**1,663,323**	2,000,086	2,101,764	1,627,010	1,191,007
Loans	**11,128,810**	9,496,503	8,572,817	8,367,205	8,084,566
Less: allowance for loan losses	**25,616**	21,416	19,466	12,467	10,267
Net loans	**11,103,194**	9,475,087	8,553,351	8,354,738	8,074,299
Other assets	**201,634**	197,338	193,144	186,064	167,522
Total assets	**$ 13,233,405**	$ 11,914,099	$ 11,191,133	$ 10,474,726	$ 9,632,274
Obligations with maturities of one year or less	**$ 7,976,947**	$ 6,556,988	$ 6,126,495	$ 7,275,126	$ 6,283,908
Obligations with maturities greater than one year	**4,302,671**	4,669,337	4,416,259	2,570,974	2,722,800
Total liabilities	**12,279,618**	11,226,325	10,542,754	9,846,100	9,006,708
Preferred Stock	**225,839**	—	—	—	—
Capital stock and participation certificates	**281,803**	301,189	300,088	305,406	307,181
Retained earnings	**439,104**	388,035	359,325	329,305	314,213
Accumulated other comprehensive income (loss)	**7,041**	(1,450)	(11,034)	(6,085)	4,172
Total shareholders' equity	**727,948**	687,774	648,379	628,626	625,566
Total liabilities and equity	**$ 13,233,405**	$ 11,914,099	$ 11,191,133	$ 10,474,726	$ 9,632,274
Consolidated Statement of Income Data					
Net interest income	**$ 184,782**	$ 135,164	$ 145,814	$ 127,775	$ 117,569
Provision for loan losses	**4,500**	2,500	7,050	2,200	1,800
Noninterest income (expense), net	**(49,676)**	(42,621)	(52,200)	(53,890)	(43,717)
Net income	**$ 130,606**	$ 90,043	$ 86,564	$ 71,685	$ 72,052
Consolidated Key Financial Ratios					
Rate of return on average:					
Total assets	**1.05%**	0.81%	0.81%	0.71%	0.77%
Total shareholders' equity	**17.40%**	12.72%	12.76%	10.86%	11.28%
Net interest income as a percentage of average earning assets	**1.50%**	1.23%	1.38%	1.28%	1.27%
Net chargeoffs (recoveries) to average loans	**0.003%**	0.01%	—	—	—
Total shareholders' equity to total assets	**5.50%**	5.77%	5.79%	6.00%	6.49%
Debt to shareholders' equity (:1)	**16.87**	16.32	16.26	15.66	14.40
Allowance for loan losses to loans	**0.23%**	0.23%	0.23%	0.15%	0.13%
Permanent capital ratio	**20.70%**	16.92%	18.86%	20.87%	23.77%
Total surplus ratio	**19.86%**	15.50%	16.72%	18.71%	19.62%
Core surplus ratio	**10.39%**	10.42%	10.89%	11.78%	11.51%
Collateral ratio	**106.38%**	104.95%	104.93%	105.07%	105.48%
Net Income Distribution					
Cash patronage	**$ 67,786**	$ 61,333	$ 59,697	$ 59,417	$ 56,561

DEAR SHAREHOLDERS



INNOVATION, ACCOUNTABILITY, VALUE...words that express our focus and frame our success. The year 2001 was an exceptional year as the financial results reported herein demonstrate. For the third consecutive year, we exceeded our forecasts and posted record earnings.

Since most of our earnings flow directly to our member-associations, our success affects their success. Our ability to generate strong returns enhances and stabilizes their earnings and provides real economic returns to their stockholders.

INNOVATION

In the dynamic world of financial institutions, change is continuous and innovation inescapable. To better serve our member-associations, AgFirst initiated a series of actions in 2001 to improve our business model:

- On May 17, we issued $225 million in preferred stock. This was the first time that a Farm Credit institution had issued capital external to the System, and we were gratified that the issue was well received by the marketplace. The additional capital accommodated significant growth in our three loan portfolios during the year.

- New systems were brought online to improve operating efficiencies.
  - — A fully integrated payroll/benefits system that gives district employees online access to their own data. The system also lets employees select their benefit options online, reducing paper flow and duplication of effort.
  - — A new loan origination system that makes the lending process quick and efficient. While allowing easy entry of loan data, the system assists in loan analysis, generates loan documents and books the transaction.
  - — A new wire transfer system that streamlines the daily movement of funds.

- AutoBorrow, a state-of-the-art cash management tool, was developed in partnership with Bank of America. This product provides a new level of control and convenience for our associations' customers.

ACCOUNTABILITY

Several years ago, we initiated a strategy to broaden our lines of business. The result has been improved returns for our stockholders and new opportunities for growth for AgFirst and its customers. Today we:

- Provide an operations center for 24 Agricultural Credit Associations, delivering timely and accurate backroom support for more than $10 billion in association loan volume. We are continually upgrading our technology and related systems to ensure that we will always be the "vendor of choice" for these retail lenders.

- Offer a capital markets function, buying and selling participation and syndicated loans. These transactions, from lenders all across the nation, provide needed geographic and industry diversification, as well as additional growth. Today, there is almost $1.6 billion outstanding in this portfolio. This lending group is well seasoned and has established relationships with a number of key banks serving food, agri-business and timber clientele.
- Purchase home, farm and part-time farm loans from more than 100 originators across the country. Our Secondary Mortgage Market servicing portfolio is approaching $1 billion in outstandings and is supported through our vital relationships with Farmer Mac and Fannie Mae.

These businesses are built on strong relationships, backed by dependable and reliable services. We know our reputation is on the line with each and every transaction. Our continued growth in these areas speaks to our commitment to quality.

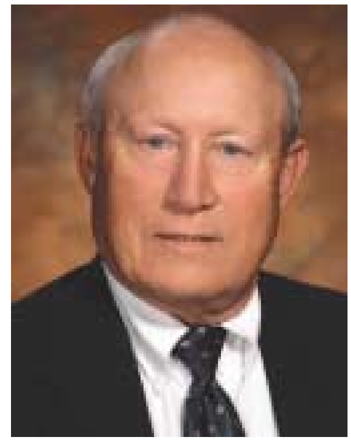
VALUE

We develop dependable and consistent streams of revenue as we actively manage hold positions, industry concentrations and adjust our lines of business to optimize our return on capital. Earnings hit record levels in 2001 with net income up by 45 percent, or $40.6 million. Our return on shareholders' equity was 17.40 percent, up from 12.72 percent in 2000. These returns are among the highest in the Farm Credit System. The fact that they were achieved in an increasingly challenging economic environment makes them all the more rewarding.

We also actively manage our liability portfolio. Most of the bank's term liabilities contain call options which are valuable in a declining interest rate environment. Rates declined dramatically in 2001. Because of the optionality embedded in our debt portfolio, we were able to call and reissue more than $9 billion of debt in 2001. As a result, we significantly reduced our interest expense and improved our earnings.

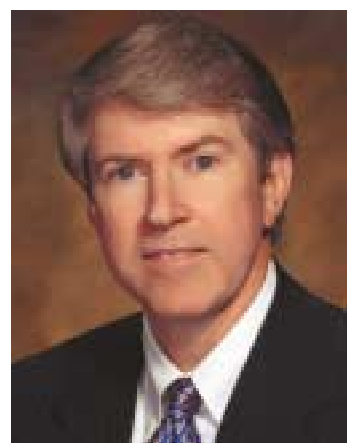
Results like these don't just happen. They are the results of employees and directors who have a passion for the business we are in and for the people of rural America we serve. I thank and congratulate each of them for making this a highly successful year.

As we enter 2002, we have a long list of further refinements, all designed to improve our ability to serve our stockholders. We believe the business model in place that rewards innovation and demands accountability, along with our commitment to excel, will again allow us to deliver the best total value to our stockholders.



F. Merrel Lust

F. MERREL LUST
Chairman of the Board



F. A. Lowrey

F. A. (ANDY) LOWREY
Chief Executive Officer

PROFILE

WHO WE ARE

AgFirst Farm Credit Bank is part of the nationwide Farm Credit System, the largest agricultural lending organization in the United States. We provide funding and financial services for 24 farmer-owned financial cooperatives in 15 eastern states and Puerto Rico. These cooperatives, called Agricultural Credit Associations, provide real estate and production financing to more than 80,000 farmers, rural homeowners and agri-businesses.

HOW WE BEGAN

AgFirst traces its origins to the establishment of the Farm Credit System in 1916. For many years, we were known as the Federal Land Bank and Federal Intermediate Credit Bank of Columbia. Although our name has changed, our mission today is the same as it was in 1916: to improve the income and well-being of American farmers and ranchers by providing them sound, adequate and constructive credit.

HOW WE ARE FUNDED

AgFirst and all of the banks in the Farm Credit System obtain their funds through the sale of notes and bonds to the investing public. Because the System issues large volumes of securities and its securities carry agency status, AgFirst and the associations it serves enjoy a dependable and competitively priced source of capital.

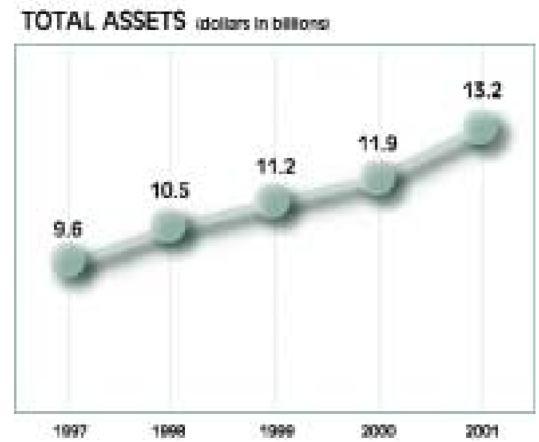
HOW WE ARE ORGANIZED

AgFirst is a federated cooperative; that is, we are a cooperative owned by other cooperatives. Like most cooperatives, we are owned and governed by our patrons, and our patrons benefit from their use of our services. AgFirst's patrons are 24 Agricultural Credit Associations (ACAs). These ACAs own stock in the bank, elect its board of directors and, at times, vote on corporate matters. As a cooperative, AgFirst can share its profits with its member-associations. Historically, we have shared a substantial portion of our earnings with our affiliated associations.

WHAT WE DO

AgFirst provides funding and services for its affiliated associations and participates with them in large loan transactions. We also partner with commercial banks, insurance companies, and other Farm Credit institutions in loan participations and syndications related to food and agriculture. Through our Capital Markets Unit, we act as an arranger, lead lender or participant in credit facilities for many large agri-businesses throughout the nation.

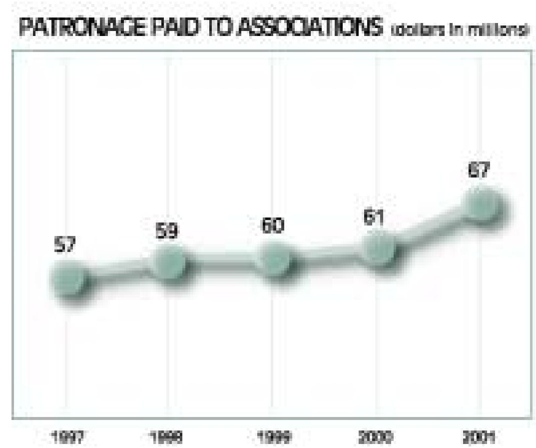
AgFirst's Secondary Mortgage Market Unit purchases rural home and agricultural loans from its affiliated associations, as well as from mortgage lenders throughout the United States. As a Fannie Mae- and Farmer Mac-approved lender and servicer, AgFirst pools and sells these loans and services them after they are sold.



PRODUCTS WE OFFER

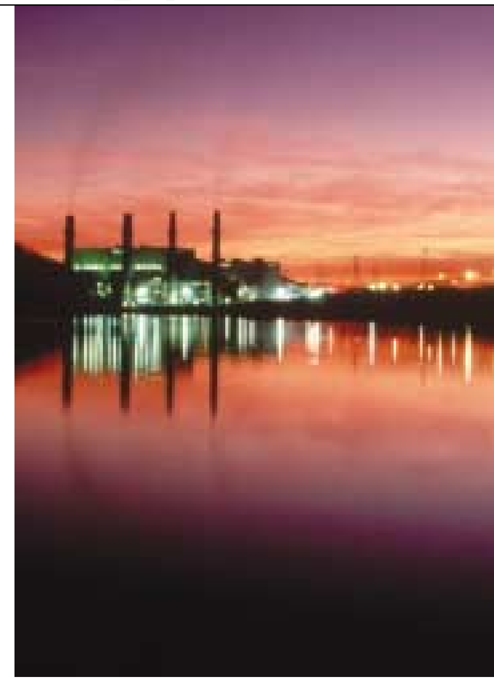
From cattle to catfish and cotton to corn, our associations finance a variety of ag operations. For that reason, AgFirst offers a wide range of loan and interest rate products including:

- Lines of Credit which enable borrowers to take advances at their choice of Prime, LIBOR, or fixed.
- AgriLine®, a totally automated system which enables borrowers to write their own loan advances by check.
- *FastCash*, another automated system that enables associations to send loan advances to their borrowers' checking accounts overnight through the Automated Clearing House system.
- AutoDraft, a product that automatically drafts borrowers' loan payments and is available for all loan types and payment frequencies.
- Account Access, which provides loan and payment information to borrowers via a secure Internet site, and LoanLine, which provides the same information by phone.
- AutoBorrow, a cash management product for commercial borrowers developed by AgFirst, in partnership with Bank of America.



innovation, accountability, value

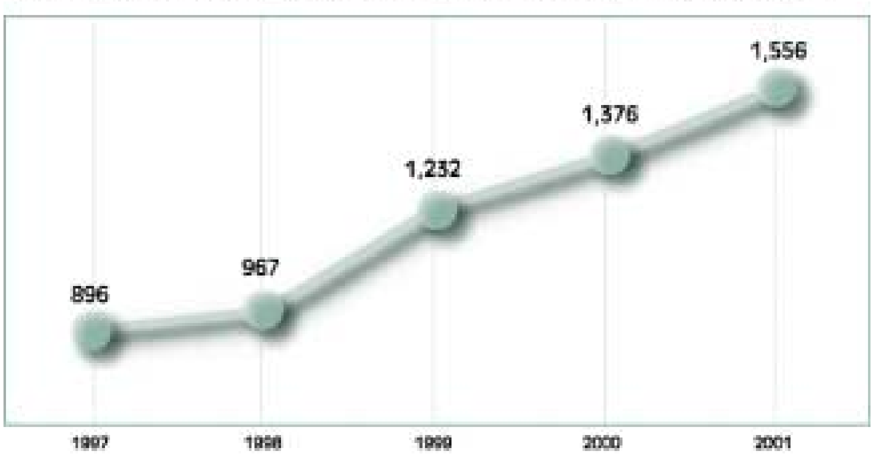
CAPITAL MARKETS



AgFirst's Capital Markets Unit buys and sells loan participations and syndications from lenders all across the nation. Our partners in these credit facilities include commercial banks, insurance companies, our member-associations and other Farm Credit institutions.

Together with our partners, we finance companies involved in the production and processing of food and fiber, as well as rural telephone systems and electric utilities. These loans provide new avenues of growth, as well as geographic and industry diversification, for AgFirst and its affiliated associations. In 2001, AgFirst's Capital Markets portfolio grew by 13 percent to $1.56 billion at year-end.

PARTICIPATIONS/SYNDICATIONS YEAR-END VOLUME (dollars in millions)



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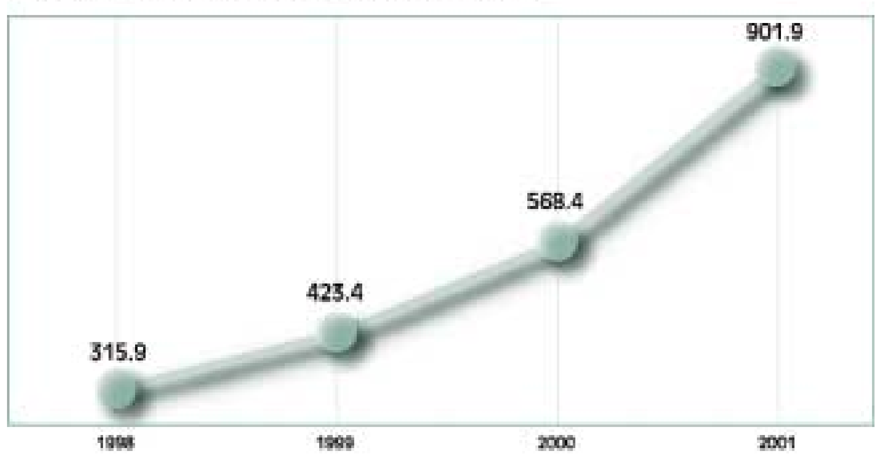
SECONDARY MORTGAGE MARKET

AgFirst's Secondary Mortgage Market Unit (SMMU) buys rural home and agricultural real estate loans from its affiliated associations and other loan originators across the United States. Many of these loans are held in portfolio, while others are sold to Farmer Mac and Fannie Mae.

Low interest rates and increased marketing efforts fueled the growth in this portfolio in 2001. Loans held in the bank's portfolio grew by 110 percent in 2001 and stood at $662 million at year-end, while our servicing portfolio grew by 59 percent during the year.

LOANS SERVICED BY SMMU (dollars in millions)




East Carolina
Farm Credit

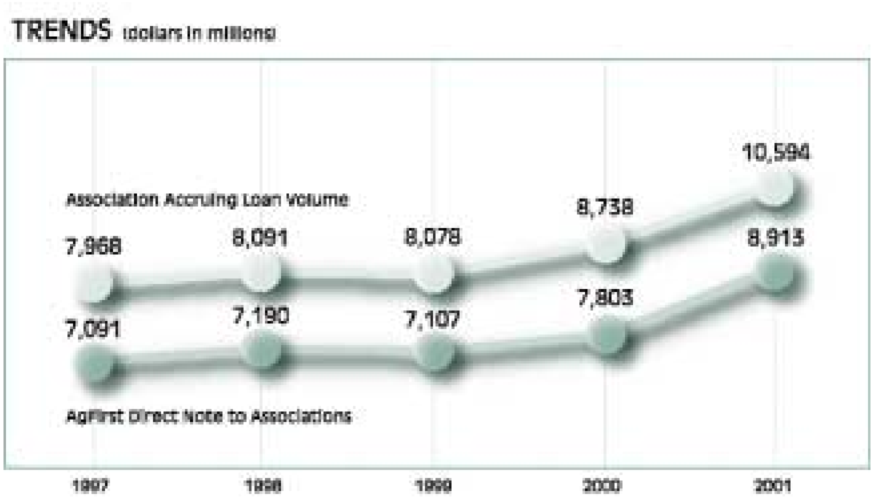
innovation, accountability, value

RETAIL

AgFirst provides funding and financial services for 24 retail financial institutions called Agricultural Credit Associations (ACAs). The ACAs are farmer-owned cooperatives that provide real estate and production financing for farmers, rural homeowners and agri-businesses.

Ag lending is a competitive business; speed and accuracy are important to lenders and their borrowers. That's why AgFirst developed Credit Delivery, a computer-based loan origination system designed to meet the special needs of ag lenders. With Credit Delivery and a laptop, a loan officer can take an application on the farm or in the office and, within minutes, print the loan documents and book the loan.

AgFirst and its shareholder-ACAs operate as true cooperatives. Just as AgFirst shares its profits with its customers, the ACAs share their profits with their borrowers. Since 1989, ACAs affiliated with AgFirst have paid patronage refunds of more than $1.5 billion to their borrowers. "Paying patronage refunds and improving stockholder value are the drivers behind a successful cooperative," says AgFirst CEO Andy Lowrey, "and our retail volume growth is a reflection of our impressive patronage refund history."



2001 FINANCIALS

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (the Bank) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all consolidated financial statements, and that the assets of the Bank are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Bank maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the chief executive officer.

The consolidated financial statements have been examined by independent public accountants, whose report appears elsewhere in this annual report. The Bank is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Bank. The undersigned certify that the 2001 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.

F. Merrel Lust
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

Leon T. Amerson
Chief Financial Officer

February 19, 2002

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

The following commentary reviews the financial condition and results of operations of AgFirst Farm Credit Bank (the Bank or AgFirst) for the years ended December 31, 2001, 2000 and 1999. This information should be read in conjunction with the accompanying consolidated financial statements, the notes to the consolidated financial statements and other sections of this annual report. See Note 1, *Organization and Operations,* in the December 31, 2001 notes to the consolidated financial statements for a discussion of the operations of AgFirst.

Financial Overview

The following information provides an overview, in capsule form, of AgFirst's financial results for the year 2001 as compared to the years 2000 and 1999:

- ❖ The aggregate principal amount of loans outstanding at December 31, 2001 was $11.1 billion compared to $9.5 billion at December 31, 2000, and $8.6 billion at December 31, 1999, reflecting increases of 17.2 percent and 29.8 percent compared to 2000 and 1999, respectively.

- ❖ Final net income totaled $131 million for the twelve months ending December 31, 2001, reflecting a 45.0 percent and 50.9 percent increase compared to the years ending December 31, 2000 and 1999, respectively.

- ❖ AgFirst's ratio of total shareholders' equity to total assets decreased from 5.77 percent at December 31, 2000 and 5.79 percent at December 31, 1999 to 5.50 percent at December 31, 2001 — primarily attributable to an increase in loans outstanding.

- ❖ AgFirst's return on average total assets and return on average shareholders' equity for the year ended December 31, 2001 were 1.05 percent and 17.40 percent, respectively, compared to .81 percent and 12.72 percent for the year ended December 31, 2000 and .81 percent and 12.76 percent for the year ended December 31, 1999.

Strategic Initiatives

AgFirst's mission statement is *"to enable our members to be the lender of choice to agriculture and rural America through cooperation and added value funds and services."* During 2001, AgFirst was involved in several major initiatives to better position itself as both the *lender of choice* and *vendor of choice* to the District Associations (the Associations).

Participation and Syndication Lending

During 2001, AgFirst increased activity in the buying and selling of loan syndications and participations within and outside the Farm Credit System. At December 31, 2001, the serviced volume of participations and syndications, which includes outstanding balances and unused commitments, totaled $2.75 billion. The Bank serves the Associations by purchasing overlines in corporate credit and by arranging syndicated transactions which allow the Associations to serve their larger customers. The Bank is an active participant in the national syndicated loan market.

Secondary Mortgage Market Activity

AgFirst maintains a Secondary Mortgage Market Unit (the SMMU) to facilitate the purchase of agricultural loans and rural home loans for eventual resale into the secondary mortgage market through FNMA ("Fannie Mae") and FAMC ("Farmer Mac") programs. The acceptance and use of the rural residential mortgage program by the Associations and a non-affiliated seller network has matured into a significant line of business within the Bank. The SMMU purchased 3,075 loans totaling $415.9 million during 2001.

Preferred Stock Issue

The District has a strong capital position, illustrated by a shareholders' equity-to-assets ratio of 15.24 percent. AgFirst is much more leveraged than the Associations, with a capital to assets ratio of only 5.50 percent. Despite its leverage, AgFirst's regulatory capital ratios are much higher than the regulatory minimum levels, as illustrated below, due to the high quality of its assets and the correspondingly low risk-weighting of those assets.

	AgFirst as of 12/31/01	Regulatory Minimum
Permanent Capital Ratio	20.70%	7.00%
Total Surplus Ratio	19.86%	7.00%
Core Surplus Ratio	10.39%	3.50%

In addition to the risk-adjusted capital measures, regulations set forth a minimum collateral ratio for Farm Credit Banks. This ratio, which is a simple leverage ratio, has no risk-weighting component and is therefore much closer to the regulatory minimum levels than the risk-based ratios.

In 2000, AgFirst set out to improve its collateral ratio without encumbering Association earnings or capital. In 2001, AgFirst achieved its objective though the issuance of $225 million of term preferred stock. The issuance of the preferred stock was significant in that it provided a platform for continued growth for the District and it established the Bank's ability to access capital through sources other than the Associations.

Project Initiatives

Beginning several years ago, the Bank initiated a plan to renovate and modernize its operating systems to improve operating efficiencies. The process continued in 2001 with the following project initiatives.

- ❖ **Credit Delivery** is a new loan origination system developed by AgFirst. The system is designed to make the lending process as quick and efficient as possible. Credit Delivery allows the Association user to enter borrower data, interface with various credit analysis applications, generate the appropriate loan documentation (including legal documents), and book the loan to the appropriate loan servicing system in an automated fashion. Implementation of Credit Delivery at the Associations began in late 2001.

- **AutoBorrow** is a cash management tool developed jointly by AgFirst and Bank of America to link Association borrowers' revolving lines of credits with their commercial checking accounts. With the AutoBorrow product, funds are automatically transferred from a borrower's line of credit to fund his checking account each time a check he writes clears the bank. Similarly, each time he makes a deposit into his checking account, those funds are automatically transferred to pay down his line of credit or, if the line is paid-in-full, to an investment account maintained by Bank of America. AutoBorrow is designed to allow Association borrowers to optimally manage their cash while borrowing from an Association.

- **GFX Wire Transfer** is a new cash management tool that will be fully implemented by the District in early 2002. The new tool streamlines the daily cash management process for the Bank and Associations.

- **Employee Self Service** is a feature of a new Human Resources/Payroll system implemented by the District in 2001. In addition to enhancing human resource and payroll administration, the new system provides 2,060 employees of the Bank and Associations secure online access to payroll and benefits information.

The District's renovation strategy continues in 2002, with projects underway to implement a new general ledger (and related financial modules) for AgFirst and the Associations and a new commercial loan system to service large syndications and participations managed by AgFirst's commercial lending department.

Results of Operations

Net Income

AgFirst net income totaled $130,606 for the year ended December 31, 2001, an increase of $40,563 over 2000, while 2000 income increased $3,479 over 1999. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

(dollars in thousands)	Year Ended December 31, 2001	2000
Net income (for prior year)	$ 90,043	$ 86,564
Increase (decrease) due to:		
Total interest income	(34,964)	94,796
Total interest expense	84,582	(105,446)
Net interest income	49,618	(10,650)
Provision for loan losses	(2,000)	4,550
Noninterest income	6,878	(1,293)
Noninterest expense	(13,933)	10,872
Total increase (decrease) in net income	40,563	3,479
Net income	$ 130,606	$ 90,043

Interest Income

Total interest income for the year ended December 31, 2001 was $740,637, a decrease of $34,964 as compared to the same period of 2000. This decrease is primarily attributed to the decreasing rate environment seen during the year 2001; however, as evidenced below, the increase in average earning assets was significant in offsetting the impact of the rate environment.

Total interest income for 2000 was $775,601, an increase of $94,796 over the same period of 1999. This increase was primarily attributed to an increase in interest rates during 2000 as well as the increase in average earning assets.

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

(dollars in thousands)	Year Ended December 31, 2001-2000	2000-1999
Increase in average earning assets	$ 1,315,379	$ 411,260
Average yield (prior year)	7.05%	6.43%
Interest income variance attributed to change in volume	92,796	26,457
Average earning assets (current year)	12,309,435	10,994,056
Increase (decrease) in average yield	(1.03%)	.62%
Interest income variance attributed to change in yield	(127,760)	68,339
Net change in interest income	$ (34,964)	$ 94,796

Interest Expense

Total interest expense for the year ended December 31, 2001 was $555,855, a decrease of $84,582 as compared to the same period of 2000. The decrease in interest expense is primarily attributed to falling interest rates and the issuance of preferred stock, offset somewhat by an increase in interest-bearing liabilities. Dividends on preferred stock, although fixed, are not reflected as expense. Rather, dividends are treated as an adjustment to capital. Since the preferred stock essentially replaced a like amount of debt, its issuance removed expense. Preferred stock dividends recognized for 2001 were $11,751.

Total interest expense for the year ended December 31, 2000 was $640,437, an increase of $105,446 over the same period of 1999. This increase was primarily due to increases in interest rates and an increase in the average daily balance of interest-bearing liabilities.

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

(dollars in thousands)	Year Ended December 31, 2001-2000	2000-1999
Increase in average interest-bearing liabilities	$ 1,150,022	$ 364,475
Average rate (prior year)	6.21%	5.38%
Interest expense variance attributed to change in average interest-bearing liabilities	71,457	19,611
Average interest-bearing liabilities (current year)	11,457,163	10,307,141
Increase (decrease) in average rate	(1.36%)	.83%
Interest expense variance attributed to change in rate	(156,039)	85,835
Net change in interest expense	$ (84,582)	$ 105,446

Net Interest Income

Net interest income decreased from 1999 to 2000 and increased from 2000 to 2001 due to a variety of factors. The following table illustrates the impact of each factor.

Analysis of Net Interest Income

(dollars in thousands)	2001 Avg. Balance	2001 Interest	2000 Avg. Balance	2000 Interest	1999 Avg. Balance	1999 Interest
Loans	$ 10,186,358	$ 636,118	$ 8,756,545	$ 627,511	$ 8,493,912	$ 565,523
Cash & Investments	2,123,077	104,519	2,237,511	148,090	2,088,884	115,282
Total Earning Assets	$ 12,309,435	$ 740,637	$ 10,994,056	$ 775,601	$ 10,582,796	$ 680,805
Interest-Bearing Liabilities	$ 11,457,163	$ (555,855)	$ 10,307,141	$ (640,437)	$ 9,942,666	$ (534,991)
Impact of Capital	$ 852,272		$ 686,915		$ 640,130	
NET INTEREST INCOME		$ 184,782		$ 135,164		$ 145,814

	2001 Average Yield	2000 Average Yield	1999 Average Yield
Yield on Loans	6.24%	7.17%	6.66%
Yield on Cash & Investments	4.92%	6.62%	5.52%
Yield on Earning Assets	6.02%	7.05%	6.43%
Cost of Interest-Bearing Liabilities	4.85%	6.21%	5.38%
Spread	1.17%	0.84%	1.05%
Impact of Capital	0.33%	0.39%	0.33%
Net Interest Income/Avg. Earning Assets	1.50%	1.23%	1.38%

Net interest income for 2001 was $49,618 greater than 2000. The increase was primarily due to a $1,315,379 increase in average earning assets, an improvement in spread, and the issuance of preferred stock.

The Bank's spread improved by 33 basis points due primarily to AgFirst's ability to exercise call options on debt during the decline in interest rates, effectively lowering its cost of funds relative to the assets, which did not prepay as quickly. The spread is expected to return to more normal levels through time, as asset prepayments "catch up" to called debt levels or as the assets and underlying funding mature or reprice in the normal course of business.

Net interest income in 2000 was $10,650 lower than 1999. The decrease was attributed to an expected contraction of spreads following an earlier period in which AgFirst temporarily improved spreads by calling a significant amount of debt during a falling rate environment. The spread contraction was partially offset by an increase in earning assets.

Provision for Loan Losses

The Bank assesses risks inherent in its portfolio on an ongoing basis and establishes an appropriate reserve for loan losses. The provision for loan losses totaled $4,500 in 2001 compared to $2,500 and $7,050 in 2000 and 1999, respectively. Despite recording a provision in each of the last three years, the ratio of allowance for loan losses to loans outstanding has remained constant due to growth in the commercial loan portfolio.

Noninterest Income

Noninterest income for the year ended December 31, 2001 was $13,509, an increase of $6,878 compared to 2000 primarily due to an increase in loan fee income. Loan fee income increased primarily as a result of increases in servicing fees on participation and secondary mortgage market loans and the collection of prepayment penalties from increased refinancing activity. Noninterest income totaled $6,631 in 2000 compared to $7,925 in 1999. The decrease in 2000 was primarily due to a decrease in miscellaneous income.

Noninterest Expense

Noninterest expense for the year ended December 31, 2001 was $63,185, an increase of $13,933 over the same period of 2000. The increase was primarily attributed to an increase of $9,191 in the amount of unamortized concession that was charged off when the underlying debt was called to take advantage of falling rates, an investment charge-off of $7,600 (offset by gains on the sale of investments totaling $2,802), and an increase in purchased services expense.

Noninterest expense decreased to $49,252 in 2000, from $60,125 in 1999. The decrease in noninterest expense was primarily attributed to the reduction on intra-System financial assistance expense referenced below.

AgFirst intra-System financial assistance expense for the year ended December 31, 2001 was $14,148 as compared to $17,317 for the year ended December 31, 2000 and $27,317 for the year ended December 31, 1999. The higher amounts in 1999 and 2000 were attributed to the call of Financial Assistance Corporation (FAC) bonds during 2000 and 1999 as described below. Under the Farm Credit Act, the System bank are required to fund bonds issued by the FAC upon maturity. Although generally accepted accounting principles (GAAP) require recognition of the obligation to fund these bonds, the Farm Credit Act states that this obligation will not be considered the liability of any System bank for financial reporting purposes. In 1998, AgFirst entered into two agreements with the other System banks and the FAC to call two of the FAC callable debt issues used to provide financial assistance (a $240 million issuance and an $89 million issuance) and to fund Capital Preservation Agreement (intra-System assistance agreements terminated in 1988) accruals (a $157 million issuance). The System banks were required to pre-fund the amounts representing the difference between the amounts previously funded and the amounts needed to call the debt. AgFirst expensed $11.4 million in 1999, related to the calling of the $157 million issuance, and $2.7 million in 2000, related to the calling of the $89 million issuance, representing its pro rata shares of the additional funding required. Ongoing financial assistance expense is expected to be significantly lower as AgFirst recognizes the cost savings associated with calling these bonds. See Note 11 – *Intra-System Financial Assistance* in the notes to the consolidated financial statements for further information.

Financial Condition

Loans

AgFirst's portfolio consists of direct notes receivable from Associations that own stock in AgFirst, loan participations purchased, loans purchased in the secondary market and loans to other regulatorily defined financing institutions serving agriculture. See Note 1(B), *Operations,* and Note 4, *Loans and Allowance for Loan Losses*, in the accompanying December 31, 2001 notes to the consolidated financial statements for further discussions.

Gross loans outstanding at December 31, 2001 totaled $11.1 billion, as compared with $9.5 billion at December 31, 2000, and $8.6 billion at December 31, 1999. The upward trend in volume is primarily attributed to growth in Association loans, which is reflected in the increase in AgFirst's direct note volume. Loans purchased in the secondary market and participations purchased increased as well.

The following table illustrates the percentages in each category to the total loan portfolio:

	At December 31,		
	2001	**2000**	**1999**
Direct notes receivable from District Associations	80.0%	82.1%	83.0%
Participations purchased	14.0	14.5	14.2
Loans purchased in the secondary market	6.0	3.3	2.7
Other	—	.1	.1
Total	100.0%	100.0%	100.0%

Association Direct Notes

As the table above illustrates, 80 percent of AgFirst's loan portfolio consists of direct notes receivable from Associations. 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. Each Association is a Federally chartered instrumentality of the United States and is regulated by the Farm Credit Administration (FCA). See Note 1, *Organization and Operations*, in the accompanying notes to the consolidated financial statements for a discussion of the Farm Credit System.

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

The diversity of income sources supporting Association loan repayment mitigates credit risk to AgFirst. In addition, the risk-bearing capacity of the Associations is assessed annually by AgFirst management and is currently deemed to be adequate to absorb most credit-related shocks. Each Association maintains an allowance for loan losses determined by its management and is capitalized to serve its unique market area. Associations are subject to minimum capital regulations of and examination by the FCA, certain regulations governing loan underwriting/portfolio management, and audit by independent accountants annually.

The District's growth is consistent with trends in other Farm Credit System institutions and is attributed to a robust agricultural economy (bolstered by record government farm spending), commercial banks reducing their exposures to agriculture, and borrowers becoming increasingly aware of the value proposition inherent in Farm Credit's cooperative structure.

Despite low prices for many commodities and a weak overall economy, 2001 is projected to reflect one of the highest years in history for net farm income, largely due to a high level of government assistance payments. Beginning in 2002, aggregate U.S. net farm income is expected to decrease as a result of reductions in government farm spending. The weakening agricultural commodities market and uncertainty surrounding continued government support for agriculture has increased the volatility in agricultural lending. Some commercial banks have sought to reduce their exposure to agriculture, resulting in increased lending opportunities for Farm Credit institutions in certain areas of AgFirst service.

Due to the geographic location of the District and the resulting types of agriculture, government programs account for a small percentage of net farm income in the territory served by the District. In addition, the diversified nature and the significant non-farm influence on the District's portfolio mitigate the impact of lower government income support for program crops.

District loan growth is also attributed to the growing favor with which borrowers are viewing Associations due to the Associations' patronage payments. Associations generally operate as cooperatives. As such, earnings are distributed to member/borrowers through patronage distributions of cash and allocated surplus. Over the past several years, a number of Associations have begun revolving (retiring) portions of their allocated surplus to their member/borrowers, resulting in significant cash payments. This tangible benefit of borrowing from an Association is a formidable marketing tool.

The District's credit portfolio is comprised of segments having varying agricultural characteristics. The following table shows the credit portfolio of the District by major commodity segment.

	Percent of Portfolio		
Commodity Group	**2001**	**2000**	**1999**
Poultry	13%	15%	15%
Forestry	10	8	8
Rural Home	10	8	6
Cattle	7	8	8
Grain	7	7	9
Dairy	6	7	7
Swine	4	6	8
Nursery/Greenhouse	4	4	4
Tobacco	4	4	4
Citrus	4	3	3
Cotton	3	3	3
Utilities	3	3	2
Other	25	24	23
Total	100%	100%	100%

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

As this table illustrates, the District's credit portfolio has concentrations that exceed five percent of the total portfolio in only six segments. It should be noted that non-farm income is typically a significant portion of the income of borrowers in the top four segments (poultry, forestry, rural home, and cattle).

District Associations serve all or portions of fifteen states and Puerto Rico. This wide geographic dispersion is a natural risk-reducing factor for the District. The following table illustrates the Associations' geographic dispersion.

	December 31, 2001	2000	1999
North Carolina	17%	18%	20%
Florida	14	14	14
Georgia	13	13	13
Virginia	11	12	13
Pennsylvania	9	9	9
South Carolina	9	8	7
Maryland	6	7	6
Ohio	5	5	4
Alabama	3	3	3
Kentucky	2	2	2
Mississippi	2	2	2
Delaware	2	2	2
Puerto Rico	2	2	2
West Virginia	2	1	1
Louisiana	2	1	1
Tennessee	1	1	1
Total	100%	100%	100%

Only North Carolina has loan volume representing more than 15 percent of the total Association portfolio, and only three other states have volume representing more than 10 percent of Association volume. The concentration in these states is mitigated by the following factors.

- ❖ Geographic location represents the source of loan origination, not necessarily the location of the borrowers' operating assets.
- ❖ Each state has some degree of commodity diversification.
- ❖ Association borrowers tend to have relatively high levels of non-farm income, especially in the rapidly growing Southeastern U.S.

Loans $5,000 in size or greater (which represents the commercial and corporate side of agribusiness) comprise approximately 7 percent of Association loan volume outstanding, net of participations sold. Approximately 58 percent of the outstanding volume is comprised of loans under $500, and loans less than $100 make up approximately 18 percent of outstanding loan volume. This diversification among borrowers is a key component of the AgFirst's stable credit quality and solid financial performance over time.

Associations employ a number of risk management techniques to limit credit exposures. Each Association has adopted underwriting standards, individual borrower hold limits, commodity hold limits, etc. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios. In addition, Associations utilize guarantees from other agencies, including Farmer Mac, the Farm Services Agency, and the Small Business Administration. At December 31, 2001, Associations had $600 million under various government guarantee programs of all types.

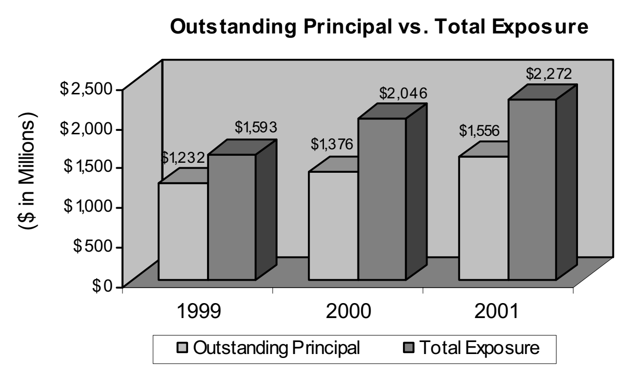
Credit quality of the Associations at December 31, 2001 improved compared to that of December 31, 2000 and 1999. Nonearning assets as a percent of total loans was 0.7 percent at December 31, 2001 compared to 0.8 percent and 1.0 percent at December 31, 2000 and 1999, respectively.

Capital Markets

The AgFirst participation portfolio sustained significant growth during fiscal years 1999 through 2001. Outstanding principal totaled $1.376 billion at December 31, 2000, an increase of $143.3 million or 11.6 percent compared to December 31, 1999. Outstanding balances climbed to $1.556 billion at December 31, 2001, a $180.7 million or 13.1 percent increase over 2000 levels. Portfolio Average Daily Balance (ADB) increased from $1.059 billion in 1999, to $1.114 billion in 2000, and closed at $1.380 billion on December 31, 2001.

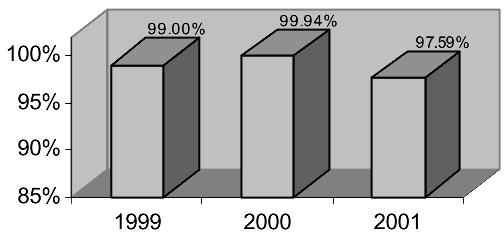
In 1996, 80 percent of the participation portfolio was composed of loans purchased from the Associations. Over the past three years, the Associations began selling loans to each other and non-System entities, and AgFirst began purchasing loans from banks and associations nationally. By fiscal year-end 1999, 68 percent of loan ADB was purchased from the Associations compared with 32 percent purchased from outside entities (i.e. CoBank, System entities and commercial banks). During 2000, portfolio ADB shifted to 56 percent Association loans and 44 percent purchased from outside entities. By the end of 2001, Association loans comprised only 42 percent of the portfolio ADB, while loans purchased from outside entities increased to 58 percent.

While volume has increased since 1999, the portfolio has been built on a foundation of strong customer retention and by adding quality credits. This expansion resulted in total participation and syndication exposure (outstanding principal plus commitments) of $2.272 billion at December 31, 2001, an increase of 43 percent over the two-year period, as illustrated below.



As the portfolio expanded, credit quality has remained high with extremely low nonaccrual and loan losses over the three-year period. The highest two credit classifications, Acceptable and Other Assets Especially Mentioned (OAEM) are represented in the following table. OAEM loan assets are considered fully collectible but have potential weaknesses. There may be minor differences between Acceptable and OAEM loan assets.

Credit Quality



Portfolio industry concentration risk is considered moderate, with the largest concentrations in electric utilities at 12 percent, followed by sugar at 9 percent, telephone utilities at 8 percent and poultry at 7 percent of total exposure (as defined above) at December 31, 2001.

Geographic risk in the participation portfolio was spread over 22 states and Puerto Rico during 1999, with significant concentrations in Florida and North Carolina. Strategic building of portfolio volume during fiscal 2000 resulted in a more even distribution of participation volume over 27 states and Puerto Rico. As a result of portfolio expansion during the two-year period, the AgFirst participation portfolio is now geographically diversified over 30 states and Puerto Rico, with only Florida's loan concentration exceeding 15 percent at the close of 2001.

Transaction risk is controlled in the portfolio by utilizing "Hold Limits," which establish aggregated lending limits for individual credits based on underwriting standards and portfolio risk management policy. Hold limits are based on term or revolver type (i.e. amortized, term, or revolving lines of credit), and expressed as a percentage of the "Lending and Investment Base," as defined in the Bank's lending guidelines. The Lending and Investment Base is currently $640 million, a level significantly lower than the Bank's permanent capital position of $878.5 million. This resulting hold position provides considerable cushion below the regulatory lending limits for individual transactions.

Secondary Mortgage Marketing Unit

Six percent of AgFirst's loans outstanding consists of loans purchased by the Bank's Secondary Mortgage Market Unit. These loans are predominately rural home loans, which carry FNMA and/or FAMC guarantees and therefore present little credit risk to AgFirst.

Liquidity and Funding Sources

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

Investments, Cash and Cash Equivalents

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

Cash and investment securities outstanding as of December 31, 2001 totaled $1.93 billion compared to $2.24 billion and $2.44 billion at December 31, 2000 and 1999. The decrease is primarily attributed to a reduction in asset-backed securities, which were liquidated due to an inadequate return relative to risk, and to faster-than-anticipated principal pay-downs of mortgage-backed securities resulting from mortgage refinancing activity. These investments were not replaced, as the liquidity reserve was adequate and the liquidation was consistent with asset/liability management objectives.

Despite the high-quality nature of its portfolio, AgFirst experienced an unusual loss during 2001. A "AAA-rated" security owned by AgFirst was downgraded to "below investment grade" in a single action. With no viable means to divest itself of the security, AgFirst wrote the value down by $7.6 million.

Systemwide Debt Securities

The primary source of funds for AgFirst is the issuance of Systemwide debt securities through the Federal Farm Credit Banks Funding Corporation. At December 31, 2001, AgFirst had $12.1 billion in total debt outstanding compared to $11.01 billion at December 31, 2000 and $10.3 billion at December 31, 1999. The year-to-year increases were primarily due to the increases in loan volume. Refer to Note 7, *Bonds and Notes,* for additional information related to debt.

Asset/Liability Management

AgFirst adheres to a philosophy that all loans should be priced competitively in the market and that loan rates and spreads should be contractually established at loan closing such that a borrower is not subject to rate changes at the discretion of management or boards of directors. Therefore, all District Association variable rate and adjustable rate loans are indexed to market rates, and fixed rate loans are priced based on market rates at closing. Loan products offered by the Associations include prime-indexed variable rate loans, LIBOR-indexed variable rate loans, one-, three- and five-year 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, including fixed payment (standard amortization) and level principal (level principal plus interest), with the ability to pay on a monthly, quarterly, semi-annual or annual frequency. In addition, "custom" repayment plans may be negotiated to fit a borrower's unique circumstances. The objective of the AgFirst asset/liability management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst's interest-earning assets and interest-bearing liabilities and interest rate sensitivity analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates. The following tables represent AgFirst's projected change in net interest income and market value of equity for various rate movements as of December 31, 2001.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
400 BP Shock	$202,678	(8.79%)
200 BP Shock	218,394	(1.72%)
0 BP	222,214	—
-84 BP Shock *	234,763	5.65%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity	% Change
Book Value	$13,067,261	$12,349,221	$718,040	—
400 BP Shock	12,266,648	11,794,408	472,240	(40.84%)
200 BP Shock	12,680,667	12,054,910	625,756	(21.60%)
0 BP	13,110,760	12,312,580	798,182	—
-84 BP Shock *	13,284,877	12,404,331	880,546	10.32%

* *Per FCA regulations, when the current three-month Treasury bill interest rate at quarter-end is less than 4 percent, both the minus 200 and minus 400 basis point shocks should be replaced with a downward shock equal to one-half of the three-month Treasury bill rate.*

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2001. 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 and anticipated prepayments and, in the case of liabilities, the exercise of call options.

Sensitivities to Changes in Interest Rates

December 31, 2001

	Repricing/Maturity Gap Analysis			
(dollars in thousands)	Less than or Equal to to 1 Year	Greater than 1 Year Less than 5 Years	Greater than or Equal to 5 Years	Total
Short and Intermediate-Term Loans				
Fixed	$ 2,214,063	$ 1,655,438	$ 683,796	$ 4,553,297
Variable	3,045,837	—	—	3,045,837
Total Short and Intermediate-Term Loans	5,259,900	1,655,438	683,796	7,599,134
Long-Term Real Estate Loans				
Fixed	860,428	1,282,718	980,835	3,123,981
Variable	324,255	79,419	2,021	405,695
Total Long-Term Real Estate Loans	1,184,683	1,362,137	982,856	3,529,676
Total Loans	6,444,583	3,017,575	1,666,652	11,128,810
Cash and Investments	1,541,957	195,299	191,321	1,928,577
TOTAL INTEREST EARNING ASSETS	$ 7,986,540	$ 3,212,874	$ 1,857,973	$ 13,057,387
Source of Funds				
Interest Bearing Liabilities	$ 8,476,709	$ 3,225,500	$ 413,500	$ 12,115,709
Preferred Stock	—	—	225,839	225,839
TOTAL SOURCE OF FUNDS	$ 8,476,709	$ 3,225,500	$ 639,339	$ 12,341,548
Interest Rate Sensitivity Gap	$ (490,169)	$ (12,626)	$ 1,218,634	$ 715,839
Sensitivity Gap as a % of Total Earning Assets	(3.75%)	(.10%)	9.33%	
Cumulative Gap	$ (490,169)	$ (502,795)	$ 715,839	
Cumulative Gap as a % of Total Earning Assets	(3.75%)	(3.85%)	5.48%	
Rate Sensitive Assets/Rate Sensitive Liabilities	.94	1.00	2.91	

At December 31, 2001, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.397 billion and purchased interest rate caps with notional amounts totaling $393.9 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. Refer to Note 17, *Derivative Instruments and Hedging Activities* in the notes to the consolidated financial statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2001.

Disclosures for Derivative Financial Instruments

Notional amounts *(dollars in millions)*	**Receive Fixed**	**Pay Fixed**	**Amortizing Floating for Floating**	**Interest Rate Caps**	**Total**
Balance at December 31, 2000	$ 996	$ —	$ 816	$ 441	$ 2,253
Maturities/amortizations	346	—	69	47	462
Balance at December 31, 2001	$ 650	$ —	$ 747	$ 394	$ 1,791

Various uses of interest rate swaps at December 31, 2001

(dollars in millions)	
Interest rate swaps utilized to create synthetic floating-rate debt to achieve a lower cost of funding	$ 650
Asset/liability management purposes	747
Total interest rate swaps outstanding	$ 1,397

Preferred Stock

On May 17, 2001, AgFirst issued $225 million of Class A Cumulative Preferred Stock. This stock is mandatorily redeemable on December 15, 2016 and carries a stated annual dividend rate of 8.393 percent, with dividends paid semi-annually on June 15th and December 15th. As of December 31, 2001, the stock had accrued unpaid dividends totaling $839. AgFirst paid dividends in 2001 in the amount of $10,912 to preferred stock investors. See Note 8 of the notes to the consolidated financial statements of this annual report for more detailed information concerning the preferred stock issue.

Capital

Total shareholders' equity at December 31, 2001 was $727,948 compared to $687,774 and $648,379 at December 31, 2000 and 1999, respectively. The increasing trend in shareholders' equity is attributed to increases in retained earnings, offset somewhat by a decrease in outstanding capital stock resulting from the retirement and redemption by AgFirst of a portion of its capital stock.

Capital adequacy is evaluated using a number of ratios. FCA Regulations establish minimum standards for the following ratios:

- Permanent capital to risk-adjusted assets (7.00 percent)
- Total surplus to risk-adjusted assets (7.00 percent)
- Core surplus to risk-adjusted assets (3.50 percent)
- Net collateral to total liabilities (104 percent)

For all periods presented throughout, AgFirst exceeded minimum standards for all of these ratios.

Refer to Note 9, *Shareholders' Equity*, in the notes to the consolidated financial statements for additional information.

Legal Proceedings

On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from legal actions pending against the Bank would be immaterial in relation to the financial position of the Bank. Refer to Note 14, *Commitments and Contingencies*, in the notes to the consolidated financial statements for additional information.

Additional Disclosures

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the consolidated financial statements, *Organization and Operations,* included in this annual report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in *Management's Discussion and Analysis of Financial Condition and Results of Operations* included in this annual report to shareholders.

Description of Property

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

Location	Description
1401 Hampton Street	Bank building and adjacent parking
1441 Hampton Street	Price Brothers, Inc.
1443 Hampton Street	AgFirst Federal Credit Union
1447 Hampton Street	Willis Chiro-Med
1428 Taylor Street	Bandgap Technologies, Inc.
1436 Taylor Street	Enterprise Car Rentals

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 14 to the consolidated financial statements, *Commitments and Contingencies,* included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 to the consolidated financial statements, *Shareholders' Equity,* included in this annual report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 7, 11 and 14 to the consolidated financial statements included in this annual report to shareholders.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations, which appears in this annual report to shareholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

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

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

Senior Officer	Position
F. A. (Andy) Lowrey	President and Chief Executive Officer
Larry R. Doyle	Executive Vice President
Thomas S. Welsh	Executive Vice President

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, 2001, 2000 and 1999, is as follows:

Name of Individual or No. in Group	Year	Annual Salary	Annual Bonus	Total
F. A. (Andy) Lowrey	2001	$ 312,648	$ 78,162	$ 390,810
F. A. (Andy) Lowrey	2000	$ 294,945	$ 73,736	$ 368,681
F. A. (Andy) Lowrey	1999	$ 280,900	$ 70,225	$ 351,125
5 Officers	2001	$ 1,001,801	$ 233,532	$ 1,235,333
5 Officers	2000	$ 942,262	$ 201,102	$ 1,143,364
5 Officers	1999	$ 890,178	$ 190,412	$ 1,080,590

In addition to a base salary, senior officers earn additional compensation under the Bank's Corporate Bonus Plan. The plan is designed to motivate employees to exceed specific performance targets related to return on equity (ROE), System CIPA score, FCA rating on quality of management and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2001 bonus was made in the first quarter of 2002.

Disclosure of the total compensation in 2001 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

(as of December 31, 2001)

Name	Position	Term of Office
F. Merrel Lust	Chairman	December 31, 2001
Richard Kriebel	Vice Chairman	December 31, 2003
E. McDonald Berryman	Director	December 31, 2001
William C. Bess, Jr.	Director	December 31, 2001
Dr. Chester D. Black	Director	December 31, 2002
Robert A. Carson	Director	December 31, 2002
R. Tommy Clay, Sr.	Director	December 31, 2004
Douglas L. Flory	Director	December 31, 2003
Don W. Freeman	Director	December 31, 2001
Robert L. Holden, Sr.	Director	December 31, 2002
Thomas W. Kelly	Director	December 31, 2004
Paul Lemoine	Director	December 31, 2003
T. Edward Lippy	Director	December 31, 2001
Eugene W. Merritt, Jr.	Director	December 31, 2002
Dale W. Player	Director	December 31, 2003
J. Dan Raines, Jr.	Director	December 31, 2001
Walter L. Schmidlen, Jr.	Director	December 31, 2004
Robert G. Sexton	Director	December 31, 2003
Robert E. Strayhorn	Director	December 31, 2004

F. Merrel Lust, Chairman of the Board, is from Marion, Ohio, and grows corn, soybeans, and wheat on a 5,900-acre operation in partnership with his twin brother, his son and his nephew. He currently serves as a member of the board of Ag Credit ACA. During 2001, he served 28 days at AgFirst board meetings and 9 days at other official board functions, and was paid $24,666 in compensation.

Richard Kriebel, Vice Chairman of the Board, is a contract crop farmer from Benton, Pennsylvania, raising contract forage and grain for total mixed rations to other dairymen in the area. His crops consist of 540 owned-and-leased acres (235 acres of corn and 305 acres of hay). He is a director of *Ag***Choice** ACA, and a former member of the Columbia County Extension and the Columbia County Planning Commission. During 2001, he served 28 days at AgFirst board meetings and 9 days at other official board functions, and was paid $24,666 in compensation.

E. McDonald Berryman is a farmer from Elberon, Virginia. His farming operations consist of 3,000 acres of row crops including peanuts, corn, wheat, soybean, milo and sows, farrow to finish and 1,000 acres of growing timber. He also serves as director of Wakefield Growers Gin and is President of Peanut Farmers LLC in Franklin, Virginia. During 2001, he served 27 days at AgFirst board meetings and 8 days at other official board functions, and was paid $24,666 in compensation.

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders Supply Co. and has brood cow operations. He serves as a director of Carolina Farm Credit, ACA and is a member of the national Farm Credit Council Board. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Dr. Chester D. Black of Raleigh, North Carolina, serves as the board's outside director. Dr. Black previously served as director of the North Carolina Agriculture Extension Service at North Carolina State University. During 2001, he served 25 days at AgFirst board meetings and 8 days at other official board functions, and was paid $24,666 in compensation.

Robert A. Carson, a row crop farmer in the Mississippi Delta, is active in a number of agriculture organizations. He is a director of the Delta Council and Plains Yazoo Cotton Oil Mill. He is also a member of the national Farm Credit Council Board. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

R. Tommy Clay, Sr., a graduate of the University of Florida, operates a cattle ranch in Putnam County, Florida, and is also involved in real estate development. For more than three decades he has also served as a director of the Putnam County Fair and the Rodeheaver Boys Ranch. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Douglas L. Flory is a general livestock, hay and poultry farmer from Grottoes, Virginia. He serves on the board of directors of the Farm Credit of the Virginias, ACA. During 2001, he served 28 days at AgFirst board meetings and 8 days at other official board functions, and was paid $24,666 in compensation.

Don W. Freeman is a farmer-rancher from Lowndesboro, Alabama. He is a director of both Lowndes County Alabama Farmers Federation and Lowndes County Cattlemen Association, and is past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Robert L. Holden, Sr. is co-owner and operator of a dairy, an 850-acre row-crop farm, and a 200,000 broiler operation in Whigham, Georgia. He is a director of the Southwest Georgia Farm Credit, ACA, a director of Georgia Milk Producers, and Georgia Farm Bureau. During 2001, he served 23 days at AgFirst board meetings and 7 days at other official board functions, and was paid $24,666 in compensation.

Thomas W. Kelly, from Tyrone, Pennsylvania, is owner-operator of a 390-acre dairy and crop farm. The dairy herd consists of 160 registered Holsteins whose genetics are merchandized to both domestic and foreign markets. Major crops include corn, alfalfa, soybeans and barley. He currently serves on the board of AgChoice Farm Credit ACA. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Paul Lemoine, a cattle and row crop farmer from Plaucheville, Louisiana, is active in a number of organizations related to farming. He is a member of the Louisiana Cattlemen's Association and the Avoyelles Parish Farm Bureau. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

T. Edward Lippy, from Hampstead, Maryland, is an equal partner and owner of Lippy Brothers, Inc., a 9,000-acre cash grain and vegetable family farm operation. He is a director of the Carroll County Farm Bureau and Hanover Foods, Inc. During 2001, he served 27 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Eugene W. Merritt, Jr., from Easley, South Carolina, is co-owner of an ornamental tree farm, and is a landscape contractor. The Clemson University graduate also operates a 400-acre timber and grass farm. He serves on the board of Palmetto Farm Credit, ACA. During 2001, he served 25 days at AgFirst board meetings and 8 days at other official board functions, and was paid $24,666 in compensation.

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. During 2001, he served 28 days at AgFirst board meetings and 10 days at other official board functions, and was paid $24,666 in compensation.

J. Dan Raines, Jr. is a farmer from Ashburn, Georgia. His farming operations include beef cattle and fresh market vegetables. A graduate of the University of Georgia, he also operates a packing shed. He is a director on the board of *Ag***Georgia** *Farm Credit, ACA* and the Federal Agricultural Mortgage Corporation (Farmer Mac). During 2001, he served 28 days at AgFirst board meetings and 9 days at other official board functions, and was paid $24,666 in compensation.

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. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Robert G. Sexton, a citrus grower, is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association, Vice President of Florida Citrus Packers, and a director of Indian River Citrus League, Seald Sweet Growers and Highland Exchange Service Co-op. He also serves as a director of Farm Credit of South Florida, ACA. In addition, he is a member of the Indian River Farm Bureau and a member of the Marketing and Advisory Committees of the Florida Department of Citrus. During 2001, he served 28 days at AgFirst board meetings and 7 days at other official board functions, and was paid $24,666 in compensation.

Robert E. Strayhorn is a farmer from Chapel Hill, North Carolina. His farming operations include brood cows, feeder calves, timber and row crops. He serves as a director on the board of Carolina Farm Credit, ACA, chairman of the Seven County Junior Livestock Show and Sale Committee, and is active in the Orange County Farm Bureau. During 2001, he served 28 days at AgFirst board meetings and 6 days at other official board functions, and was paid $24,666 in compensation.

Compensation of Directors

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 $185,267 for 2001, $159,655 for 2000, and $168,389 for 1999. Subject to approval by the board, AgFirst allows directors to attend other meetings, committee meetings, or special assignments in addition to service at AgFirst board meetings. Total compensation paid to directors as a group was $468,654 during 2001.

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

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

Relationship with Independent Public Accountants

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

Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 19, 2002, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Copies of the Bank's annual and quarterly reports are available upon request free of charge by calling 1-800-874-7737, ext. 503, or writing Patti Trotter, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. These reports can also be viewed or obtained by going to the Bank's website at ***www.AgFirst.com***.

Report of Independent Accountants

PricewaterhouseCoopers LLP
905 East Main Street
Spartanburg, SC 29302
Telephone (864) 577 8810

Report of Independent Accountants

To the Board of Directors and Shareholders
of *Ag***First** *Farm Credit Bank*

We have audited the accompanying consolidated balance sheets of AgFirst Farm Credit Bank and its subsidiary as of December 31, 2001, 2000, and 1999, and the related consolidated statements of income, of changes in shareholders' equity, and of cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank and its subsidiary at December 31, 2001, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

February 19, 2002

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2001	December 31, 2000	December 31, 1999
Assets			
Cash and cash equivalents	$ 265,254	$ 241,588	$ 342,874
Investment securities	1,663,323	2,000,086	2,101,764
Loans	11,128,810	9,496,503	8,572,817
Less: allowance for loan losses	25,616	21,416	19,466
Net loans	11,103,194	9,475,087	8,553,351
Accrued interest receivable	56,771	72,101	61,762
Investments in other Farm Credit System institutions	77,765	78,623	77,799
Premises and equipment, net	16,822	9,889	5,805
Other assets	50,276	36,725	47,778
Total assets	$ 13,233,405	$ 11,914,099	$ 11,191,133
Liabilities			
Bonds and notes	$ 12,115,709	$ 11,014,557	$ 10,327,067
Accrued interest payable	60,442	120,708	114,803
Other liabilities	103,467	91,060	100,884
Total liabilities	12,279,618	11,226,325	10,542,754
Commitments and contingencies (Note 14)			
Preferred Stock (Note 8)	225,839	—	—
Shareholders' Equity			
Capital stock and participation certificates	281,803	301,189	300,088
Retained earnings	439,104	388,035	359,325
Accumulated other comprehensive income (loss)	7,041	(1,450)	(11,034)
Total shareholders' equity	727,948	687,774	648,379
Total liabilities and equity	$ 13,233,405	$ 11,914,099	$ 11,191,133

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2001	2000	1999
Interest Income			
Investment securities and other	$ 104,519	$ 148,090	$ 115,282
Loans	636,118	627,511	565,523
Total interest income	740,637	775,601	680,805
Interest Expense	555,855	640,437	534,991
Net interest income	184,782	135,164	145,814
Provision for loan losses	4,500	2,500	7,050
Net interest income after provision for loan losses	180,282	132,664	138,764
Noninterest Income			
Loan fees	12,200	4,911	4,448
Miscellaneous	1,309	1,720	3,477
Total noninterest income	13,509	6,631	7,925
Noninterest Expenses			
Salaries and employee benefits	17,515	16,191	15,938
Occupancy and equipment	7,147	6,232	4,666
Intra-System financial assistance expenses	14,148	17,317	27,317
Realized losses on investments, net	4,798	—	1
Other operating expenses	9,791	8,996	10,656
Miscellaneous	9,786	516	1,547
Total noninterest expenses	63,185	49,252	60,125
Net income	$ 130,606	$ 90,043	$ 86,564

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

Consolidated Statements of Changes in Shareholders' Equity

(dollars in thousands)	Preferred Stock	Capital Stock and Participation Certificates	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 1998	$ —	$ 305,406	$ 329,305	$ (6,085)	$ 628,626
Comprehensive income					
Net income			86,564		86,564
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments				(4,949)	(4,949)
Total comprehensive income					81,615
Capital stock/participation certificates issued/retired, net		(2,165)			(2,165)
Cash patronage			(59,697)		(59,697)
Capital conversion		(3,153)	3,153		—
Balance at December 31, 1999	—	300,088	359,325	(11,034)	648,379
Comprehensive income					
Net income			90,043		90,043
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments				9,584	9,584
Total comprehensive income					99,627
Capital stock/participation certificates issued/retired, net		1,101			1,101
Cash patronage			(61,333)		(61,333)
Balance at December 31, 2000	—	301,189	388,035	(1,450)	687,774
Comprehensive income					
Cumulative effect of a change in accounting for derivatives				(1,037)	(1,037)
Net income			130,606		130,606
Unrealized gains (losses) on investments available for sale				12,588	12,588
Change in fair value of derivative instruments				(3,060)	(3,060)
Total comprehensive income					139,097
Preferred stock issued	225,000				225,000
Capital stock/participation certificates issued/retired, net		(19,386)			(19,386)
Preferred stock dividends paid			(10,912)		(10,912)
Preferred stock dividends accrued	839		(839)		—
Cash patronage			(67,786)		(67,786)
Balance at December 31, 2001	$ 225,839	$ 281,803	$ 439,104	$ 7,041	$ 953,787

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2001	2000	1999
Cash flows from operating activities:			
Net income	$ 130,606	$ 90,043	$ 86,564
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	2,731	2,213	1,936
Provision for loan losses	4,500	2,500	7,050
Realized (gains) losses on investments, net	4,798	—	1
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	15,330	(10,339)	(3,505)
(Increase) decrease in investments in other Farm Credit System institutions	858	(824)	(7,226)
(Increase) decrease in other assets	(13,551)	11,053	4,382
Increase (decrease) in accrued interest payable	(60,266)	5,905	35,897
Increase (decrease) in other liabilities	12,407	(9,824)	4,109
Total adjustments	(33,193)	684	42,644
Net cash provided by operating activities	97,413	90,727	129,208
Cash flows from investing activities:			
Investment securities purchased	(2,346,707)	(1,977,974)	(2,366,529)
Investment securities sold or matured	2,691,260	2,089,236	1,886,825
Net (increase) decrease in loans	(1,632,607)	(924,236)	(205,783)
Purchase of premises and equipment, net	(9,664)	(6,297)	(2,667)
Proceeds from sale of other property owned	—	—	120
Net cash used in investing activities	(1,297,718)	(819,271)	(688,034)
Cash flows from financing activities:			
Bonds and notes issued	44,526,761	25,714,904	36,069,144
Bonds and notes retired	(43,429,706)	(25,027,414)	(35,412,496)
Preferred stock issued	225,000	—	—
Capital stock and participation certificates issued/retired, net	(19,386)	1,101	(2,165)
Patronage refunds and dividends paid	(67,786)	(61,333)	(59,697)
Dividends paid on preferred stock	(10,912)	—	—
Net cash provided by financing activities	1,223,971	627,258	594,786
Net increase (decrease) in cash and cash equivalents	23,666	(101,286)	35,960
Cash and cash equivalents, beginning of period	241,588	342,874	306,914
Cash and cash equivalents, end of period	$ 265,254	$ 241,588	$ 342,874
Supplemental schedule of non-cash investing and financing activities:			
Loans transferred to other property owned	$ —	$ —	$ 120
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ 3,199	$ —	$ —
Increase (decrease) in bonds and notes	9,610	—	—
Decrease (increase) in other assets	(11,248)	—	—
Increase (decrease) in other liabilities	5,734	—	—
Supplemental information:			
Interest paid	$ 616,121	$ 634,532	$ 499,094

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

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

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as Associations. AgFirst and its related associations (District Associations) are collectively referred to as the District. The District Associations jointly own virtually all of AgFirst's stock.

As of December 31, 2000, the District consisted of twenty-six ACAs and one PCA. Effective January 1, 2001, four ACAs merged into one ACA and the one PCA reorganized as an ACA, resulting in a total of twenty-four ACAs.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used to (1) ensure the timely payment of principal and interest on Systemwide debt obligations (insured debt), (2) ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations). When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services which can be offered by the Bank.

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

The Associations borrow from the Bank and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members. Prior to January 1, 2001, the Bank provided short- and intermediate-term funding to the PCA, which has now reorganized as an ACA.

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

The Bank is also authorized to provide, in participation with other lenders and the secondary market, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The Bank may also lend to qualifying financial institutions engaged in lending to eligible borrowers.

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

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

- *Federal Farm Credit Banks Funding Corporation (Funding Corporation)* — provides for the issuance, marketing and processing of Systemwide debt securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.

- *FCS Building Association* — leases premises and equipment to the FCA.

- *Farm Credit Leasing Services Corporation* — provides a variety of leasing services for agricultural-related equipment and facilities.

- *Farm Credit System Association Captive Insurance Company* — being a reciprocal insurer, 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 Bank conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires the management of the Bank to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results can differ from these estimates. Certain amounts in prior years' financial statements have been reclassified to conform to the current year presentation.

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

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

B. **Investment Securities:** The Bank, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Bank's investments may not necessarily be held to maturity and accordingly have been classified as available for sale. Prior to the adoption on January 1, 2001, of Statement of Financial Accounting Standards (SFAS) No. 133 as amended, *Accounting for Derivative Instruments and Hedging Activities*, these investments were reported at fair value together with the fair values of the related hedges in Investment Securities in the Consolidated Balance Sheet. Beginning January 1, 2001, the fair values of the related hedges are reported in other assets or other liabilities in the Consolidated Balance Sheet. Changes in the fair value of investments classified as available for sale and of the related hedges are reflected as direct charges or credits to shareholders' equity. Realized gains and losses are determined using the specific identification method and are recognized in current operations.

C. **Loans and Allowance for Loan Losses:** Loans are carried at their principal amount outstanding less unearned income adjusted for SFAS No. 133 valuation adjustments. Interest on loans is accrued and credited to interest income based upon the principal amount outstanding.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, payments received in cash may be 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. 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."

In cases where a borrower experiences financial difficulties and the Bank makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

Statement of Financial Accounting Standards No. 91 (SFAS No. 91), *Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans and Initial Direct Costs of Leases*, requires loan origination fees and direct loan origination costs to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield. SFAS No. 91 has not been implemented by the Bank because the effects are considered by management to not be material to the financial position or results of operations of the Bank.

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated 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. Loan principal and interest, when appropriate, are charged against the allowance for loan losses if collection is unlikely.

The allowance for loan losses is based upon 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.

D. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful life of the asset. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.

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

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

F. **Employee Benefit Plans:** Bank employees participate in a districtwide defined benefit retirement plan within the District. The "Projected Unit Credit" actuarial method is used for financial reporting purposes and the "Entry-Age Normal Cost" method for funding purposes.

The employees of the Bank are eligible to participate in the thrift/deferred compensation plan (Thrift Plan) of the Bank; 50 percent of employee contributions up to a maximum employee contribution of 6 percent of total compensation is matched by the Bank. Thrift Plan costs are expensed as funded.

In addition to providing pension benefits, the Bank provides certain health care and life insurance benefits for retired employees (other postretirement benefits). Substantially all of the Bank's employees are eligible for those benefits when they reach normal retirement age while working for the Bank.

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

H. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. On January 1, 2001, the Bank adopted SFAS No. 133, as amended, which requires derivatives to be recorded in the consolidated balance sheet as assets and liabilities, measured at fair value. Prior to January 1, 2001, derivatives were off-balance-sheet financial instruments, and thus, were not reflected in the balance sheet.

In accordance with SFAS No. 133, on the date that the Bank enters into a derivative contract, it designates the instrument as (1) a hedge of (a) the fair value of a recognized asset of liability or (b) an unrecognized firm commitment (a fair value hedge); or (2) a hedge of (a) forecasted transaction or (b) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that qualifies as and is designated as a fair value hedge and is highly effective as such a hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk are reported in current period earnings. Changes in the fair value of a derivative that qualifies as and is designated as a cash flow hedge and is highly effective as such a hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction. Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) would be 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 discontinues hedge accounting prospectively when the Bank determines that (1) a derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued, the Bank will continue to carry the derivative on the balance sheet at its fair value but cease to adjust the hedged asset or liability for changes in fair value. When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Bank will continue to carry the derivative on the balance sheet at its fair value, removing from the balance sheet any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current-period earnings. When the Bank discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in 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 the fair value in current period earnings.

The Bank occasionally purchases 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.

In accordance with the transition provisions of SFAS No. 133, the Bank recorded a net-of-tax cumulative-effect adjustment for a change in accounting for derivatives to other comprehensive income in the amount of $(1,037) on January 1, 2001.

Note 3 — Investment Securities

A summary of the amortized cost and fair value of debt securities held as investments at December 31, 2001, 2000 and 1999, is as follows:

	December 31, 2001				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Agency-backed ARM securities	$ 646,972	$ 12,812	$ (71)	$ 659,713	4.98%
Collateralized mortgage obligations	516,449	3,616	(5,296)	514,769	4.91
Other asset-backed securities	208,209	78	(22)	208,265	2.55
CDs, commercial paper and other	280,555	23	(2)	280,576	2.15
Total Investment Securities	$ 1,652,185	$ 16,529	$ (5,391)	$ 1,663,323	4.17%

	December 31, 2000				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Agency-backed ARM securities	$ 863,292	$ 2,984	$ (4,261)	$ 862,015	6.75%
Collateralized mortgage obligations	421,194	2,260	(1,283)	422,171	7.15
Other asset-backed securities	617,199	671	(1,801)	616,069	7.05
CDs, commercial paper and other	99,851	—	(20)	99,831	7.02
Total Investment Securities	$ 2,001,536	$ 5,915	$ (7,365)	$ 2,000,086	6.94%

	December 31, 1999				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Agency-backed ARM securities	$ 936,992	$ 392	$ (7,447)	$ 929,937	6.17%
Collateralized mortgage obligations	392,270	98	(4,569)	387,799	5.95
Other asset-backed securities	318,833	196	(91)	318,938	6.26
CDs, commercial paper and other	464,703	387	—	465,090	6.32
Total Investment Securities	$ 2,112,798	$ 1,073	$ (12,107)	$ 2,101,764	6.18%

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2001, follows:

	Amortized Cost	Fair Value
In one year or less	$ 316,352	$ 316,355
After one year through five years	78,118	78,145
After five years through ten years	—	—
After ten years	741,266	754,054
Collateralized mortgage obligations	516,449	514,769
Total	$ 1,652,185	$ 1,663,323

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,		
	2001	2000	1999
Proceeds on sales	$ 460,356	$ —	$ 150,311
Realized gains	3,299	—	4
Realized losses	8,097	—	5

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2001	2000	1999
Direct notes receivable from District Associations	$ 8,913,269	$ 7,802,732	$ 7,107,148
Participations, net	1,556,413	1,375,691	1,232,403
Mortgage loans purchased in the secondary market	661,648	315,526	230,329
SFAS No. 133 Adjustment	(3,199)	—	—
Other	679	2,554	2,937
Total	$ 11,128,810	$ 9,496,503	$ 8,572,817

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

Total loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	2001	2000	1999
Poultry	13%	15%	15%
Forestry	10	8	8
Rural Home	10	8	6
Cattle	7	8	8
Grain	7	7	9
Dairy	6	7	7
Swine	4	6	8
Nursery/Greenhouse	4	4	4
Tobacco	4	4	4
Citrus	4	3	3
Cotton	3	3	3
Utilities	3	3	2
Other	25	24	23
Total	100%	100%	100%

Impaired loans are loans for 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 average recorded investment in impaired loans during 2001, 2000 and 1999 was $768, $8,668 and $13,032, respectively. Impaired loans of $704, $902 and $12,287 at December 31, 2001, 2000 and 1999 had a specific allowance for loan losses totaling $0, $0 and $2,300, respectively.

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

	Year Ended December 31, 2001	2000	1999
Balance at beginning of year	$ 21,416	$ 19,466	$ 12,467
Provision for loan losses	4,500	2,500	7,050
Loans charged off	(300)	(550)	(51)
Balance at end of year	$ 25,616	$ 21,416	$ 19,466

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2001	2000	1999
Land	$ 848	$ 848	$ 848
Buildings and improvements	3,151	4,816	4,445
Furniture and equipment	25,844	22,226	17,051
	29,843	27,890	22,344
Less: accumulated depreciation	13,021	18,001	16,539
Total	$ 16,822	$ 9,889	$ 5,805

Note 6 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31, 2001	2000	1999
Other assets:			
Accounts receivable from District Associations	$ 9,521	$ 9,059	$ 14,458
Prepaid expenses	65	173	439
Financial Assistance Corporation prefunding (Note 11)	—	—	2,728
Unamortized debt issue costs	5,494	4,438	4,882
Prepaid pension costs	8,845	7,492	6,935
Deferred issuance costs – preferred stock	2,608	—	—
Derivative assets	11,248	—	—
Receivables and other	12,495	15,563	18,336
Total	$ 50,276	$ 36,725	$ 47,778
Other liabilities:			
Other postretirement benefits liability	$ 9,602	$ 9,064	$ 8,428
Accounts payable	77,135	70,100	72,356
Financial Assistance Corporation payable	8,959	10,161	11,909
Derivative liabilities	5,734	—	—
Other	2,037	1,735	8,191
Total	$ 103,467	$ 91,060	$ 100,884

Note 7 — Bonds and Notes

The Bank's participation in bonds and notes follows:

	December 31, 2001	2000	1999
Systemwide bonds	$ 9,871,936	$ 6,456,729	$ 4,051,786
Systemwide medium-term notes	44,000	2,579,000	4,631,000
Systemwide discount notes	2,035,723	1,813,946	1,482,398
Other notes payable	164,050	164,882	161,883
Total	$ 12,115,709	$ 11,014,557	$ 10,327,067

Systemwide bonds, medium-term notes, master notes, discount notes and global debt securities (Systemwide debt securities) are the joint and several obligations of the System banks.

The aggregate maturities of bonds and notes and the weighted average interest rate of AgFirst at December 31, 2001, are as follows:

Year of Maturity	Weighted Average Interest Rate	Amount
2002	3.41%	$ 7,868,380
2003	3.30	1,606,976
2004	4.00	1,147,000
2005	5.15	608,796
2006	5.12	439,533
Subsequent years	6.18	445,024
Total	3.70%	$ 12,115,709

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2001, was 26 days.

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

Amount	First Call Date	Year of Maturity
$ 4,044,000	2002	2002 – 2008
10,000	2003	2005 – 2005
$ 4,054,000		

Certain conditions must be met before the Bank can participate in the issuance of Systemwide debt securities. As one condition of participation, the Bank 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. At December 31, 2001, the Bank was and currently remains in compliance with the conditions of participation for the issuances of Systemwide debt securities.

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide debt securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund; all other liabilities on the financial statements are uninsured. At December 31, 2001 the assets of the Insurance Fund aggregated $1.718 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund will be used to repay, upon maturity, the Financial

Assistance Corporation debt issued to fund the purchase of $374 million of preferred stock issued by the Federal Land Bank of Jackson, to the extent that funds of the Financial Assistance Corporation Trust Fund (Trust Fund) are not sufficient for such purpose. As of December 31, 2001, available funds in the Trust Fund amounted to $122.6 million.

The Bank had no committed commercial bank lines of credit at December 31, 2001.

Note 8 — Mandatorily Redeemable Preferred Stock

On May 17, 2001, the Bank issued $225 million of mandatorily redeemable cumulative preferred stock representing 225,000 shares at $1,000 per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable at the rate of 8.393 percent per annum of the $1,000 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 $1,000 per share. Although the mandatorily redeemable preferred stock has not been included in capital for financial reporting purposes, this preferred stock qualifies as capital for certain regulatory purposes.

Note 9 — Shareholders' Equity

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

A. **Description of Equities:**

In accordance with the Farm Credit Act and the Bank's capitalization bylaws, the Bank is authorized to issue and have outstanding Classes B, C, and D Common Stock, Participation Certificates 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 the Bank's business. All stock and Participation Certificates have a par or face value of five dollars ($5.00) per share.

The Bank had the following shares outstanding at December 31, 2001:

		Shares Outstanding	
Class	**Protected Status**	**Number**	**Aggregate Par Value**
B Common/Nonvoting	No	7,966,436	$ 39,832
C Common/Voting	No	45,438,488	227,193
D Common/Nonvoting	No	2,892,540	14,463
C Participation Certificates/Nonvoting	No	63,023	315
Total Capital Stock and Participation Certificates		56,360,487	$ 281,803

B. **Capital Stock:**

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

Additionally, the Bank has issued Class D Common Stock in connection with participations carried by the Bank from other System institutions. Class D Common Stock shall have voting rights, except with respect to such participations. Such Stock may be retired at the discretion of the Board, and, if retired, shall be retired at book value, not to exceed its par value. Class D Common Stock shall be purchased by borrowers eligible to hold it as a condition for obtaining a loan in an amount as may be determined by the Board at its discretion within a range between a minimum of two percent (2%) of the loan amount or $1,000.00, whichever is less, and a maximum not to exceed ten percent (10%) of the loan amount.

C. **Other Equity:**

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

D. **Regulatory Capitalization Requirements and Restrictions:**

FCA's capital adequacy regulations require the Bank to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. The Bank is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA Regulations also require all System institutions to achieve and maintain additional capital adequacy ratios as defined by FCA Regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Bank's permanent capital, total surplus and core surplus ratios at December 31, 2001 were 20.70 percent, 19.86 percent and 10.39 percent, respectively.

Additionally, the Bank is required to achieve and maintain net collateral of 104 percent of total liabilities. At December 31, 2001, the Bank's net collateral was 106.38 percent.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Bank has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

Note 10 — Employee Benefit Plans

The Bank participates in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Bank employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times the Bank's salary expense as a percentage of the District's salary expense.

The Bank also participates in a Districtwide Thrift Plan. The Thrift Plan requires the Bank to match 50 percent (50%) of employee optional contributions up to a maximum employee contribution of 6 percent (6%) of total compensation.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Bank charges related to this plan are an allocation of District charges based on the Bank's proportional share of the plan liability.

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

	2001	2000	1999
Pension	$ 254	$ 173	$ 165
Thrift/deferred compensation	325	320	320
Other postretirement benefits	1,634	1,451	1,193
Total	$ 2,213	$ 1,944	$ 1,678

Note 11 — Intra-System Financial Assistance

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

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

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

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

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

In 1998, the Bank entered into two agreements with the other System banks and the FAC to call certain of the FAC callable debt issues used to provide financial assistance ($240 million issuance and $89 million issuance) and to fund Capital Preservation Agreement accruals ($157 million issuance). The System banks were required to pre-fund the amounts representing the difference between the amounts previously funded and the amounts needed to call the debt. The Bank expensed $5.9 million in 1998 related to the calling of the $240 million issuance, $11.4 million in 1999 related to the calling of the $157 million issuance, and $2.7 million in 2000 relating to the calling of the $89 million issuance, representing its pro rata shares of the additional funding required.

The Bank's financial assistance expense totaled $14 million, $17 million and $27 million in 2001, 2000 and 1999, respectively.

Note 12 — Related Party Transactions

As discussed in Note 1, the Bank lends funds to the District Associations to fund their loan portfolios. Further disclosure regarding these related party transactions is found in Notes 4, 6, 9 and 14.

Interest income recognized on direct notes receivable from District Associations was $513,919, $521,089 and $475,072 for 2001, 2000 and 1999, respectively.

Note 13 — Regulatory Enforcement Matters

At December 31, 2001, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 14 — Commitments and Contingencies

The Bank has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to the consolidated financial statements. While primarily liable for its portion of bonds and notes, the Bank is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2001, were $81 billion.

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

Note 15 — Financial Instruments With Off-Balance-Sheet Risk

The Bank may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2001, $729.4 million of commitments to extend credit and $27.3 million of letters of credit and guarantees 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. 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. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

In addition, the Bank owns an 18 percent minority interest in the Farm Credit Leasing Services Corporation (FCLSC), a subsidiary of CoBank, ACB, which is also a bank of the Farm Credit System and is regulated by FCA. Pursuant to a stockholder agreement, AgFirst guarantees its 18 percent pro rata share of FCLSC's note payable to CoBank. At December 31, 2002, the Bank's portion of the FCLSC note payable to CoBank totaled $148.4 million.

Note 16 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Bank's financial instruments at December 31, 2001, 2000 and 1999. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

	December 31, 2001		December 31, 2000		December 31, 1999	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$ 11,128,810	$ 10,993,159	$ 9,496,503	$ 9,490,553	$ 8,572,817	$ 8,508,749
Allowance for loan losses	(25,616)	—	(21,416)	—	(19,466)	—
Loans, net	$ 11,103,194	$ 10,993,159	$ 9,475,087	$ 9,490,553	$ 8,553,351	$ 8,508,749
Derivative assets**	$ 11,248	$ 11,248	$ —	$ —	$ —	$ —
Cash & investment securities	$ 1,928,577	$ 1,928,577	$ 2,245,087	$ 2,245,087	$ 2,446,892	$ 2,446,892
Related interest rate swaps	—	—	(3,413)	(3,413)	(2,254)	(2,254)
Net cash & investment securities	$ 1,928,577	$ 1,928,577	$ 2,241,674	$ 2,241,674	$ 2,444,638	$ 2,444,638
Financial liabilities:						
Systemwide debt securities	$ 12,115,709	$ 12,134,913	$ 11,014,557	$ 11,032,565	$ 10,327,067	$ 10,244,399
Financial assistance related liabilities*	$ 8,959	$ 12,575	$ 10,161	$ 13,780	$ 11,909	$ 15,880
Derivative liabilities**	$ 5,734	$ 5,734	$ —	$ —	$ —	$ —

* *The above amount excludes the assumption of Third Quarter 1986 Capital Preservation Agreement obligations with a fair value of $6.7 million at December 31, 2001.*
** *Due to the adoption of SFAS No. 133, derivative financial instruments are recorded on the Consolidated Balance Sheets beginning on January 1, 2001.*

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

A. **Loans:** Because no active market exists for the District's loans, fair value is estimated by discounting the expected future cash flows using the District's current interest rates at which similar loans would be made to borrowers with similar credit risk. Since the discount rates are based on the District's loan rates as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

   For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool. Fair value of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. The carrying value of accrued interest approximates its fair value.

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

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

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

E. **Financial Assistance Related Liabilities:** As discussed in Note 11, the District is liable for certain obligations of the Financial Assistance Corporation, one of which is unrecorded. Fair value of these obligations is determined by discounting the cumulative expected future cash outflows of all of the obligations using an interest rate commensurate with bonds having a similar maturity.

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

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

Note 17 — Derivative Instruments and Hedging Activities

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

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

The Bank may purchase interest rate options such as caps, in order to reduce the impact of rising interest rates on their floating-rate debt, and floors, in order to reduce the impact of falling interest rates on their floating-rate assets. It has been determined that the Bank's purchased caps qualify for hedge accounting treatment. There are no floors outstanding currently.

By using derivative instruments, the Bank exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the Bank's credit risk will equal the fair value gain in a derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the Bank, thus creating a repayment risk for the Bank. When the fair value of the derivative contract is negative, the Bank owes the counterparty and, therefore, assumes no repayment risk. The Bank minimizes the credit (or repayment) risk by entering into transactions with high-quality counterparties that are reviewed periodically by its Credit Committee. Further, when considered necessary, the Bank may request that collateral be provided by the counterparty.

The Bank also maintains a policy of requiring that all derivative contracts be governed by a master agreement and/or bilateral collateral arrangements. When the Bank is engaged in more than one outstanding derivative transaction with the same counterparty and also has a master netting agreement with the counterparty, the "net" mark-to-market exposure represents the netting of the positive and negative exposures with that counterparty.

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

Information is provided below for each significant derivative product type at December 31, 2001.

December 31, 2001 ($ in millions)	Maturities of 2001 Derivative Products 2002	2003	2004	2005	2006	After 2006	Total
Receive fixed swaps							
Notional value	$ 650	$ —	$ —	$ —	$ —	$ —	$ 650
Weighted average receive rate	5.49%	—	—	—	—	—	5.49%
Weighted average pay rate	2.00%	—	—	—	—	—	2.00%
Amortizing floating for floating swaps							
Notional value	—	—	100	279	368		747
Weighted average receive rate	—	—	4.95%	3.79%	4.32%	—	4.21%
Weighted average pay rate	—	—	6.38%	4.52%	4.82%	—	4.92%
Other derivative products							
Notional value — Interest rate caps	—	—	—	200	194	—	394
Total notional value	$ 650	$ —	$ 100	$ 479	$ 562	$ —	$ 1,791

Notional amounts ($ in millions)	Receive Fixed	Amortizing Floating For Floating	Interest Rate Caps	Total
Balance at December 31, 2000	$ 996	$ 816	$ 441	$ 2,253
Maturities/amortizations	346	69	47	462
Balance at December 31, 2001	$ 650	$ 747	$ 394	$ 1,791

Note 18 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2001, 2000 and 1999 follow:

2001	First	Second	Third	Fourth	Total
Net interest income	$ 35,061	$ 40,993	$ 49,245	$ 59,483	$ 184,782
Provision for loan losses	1,000	—	2,000	1,500	4,500
Noninterest income (expense), net	(8,432)	(9,661)	(18,465)	(13,118)	(49,676)
Net income	$ 25,517	$ 31,332	$ 28,892	$ 44,865	$ 130,606

2000	First	Second	Third	Fourth	Total
Net interest income	$ 33,340	$ 32,440	$ 34,268	$ 35,116	$ 135,164
Provision for loan losses	—	—	1,500	1,000	2,500
Noninterest income (expense), net	(9,715)	(9,823)	(12,342)	(10,741)	(42,621)
Net income	$ 23,625	$ 22,617	$ 20,426	$ 23,375	$ 90,043

1999	First	Second	Third	Fourth	Total
Net interest income	$ 36,455	$ 35,799	$ 36,623	$ 36,937	$ 145,814
Provision for loan losses	1,000	1,050	2,000	3,000	7,050
Noninterest income (expense), net	(21,168)	(9,548)	(10,377)	(11,107)	(52,200)
Net income	$ 14,287	$ 25,201	$ 24,246	$ 22,830	$ 86,564

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