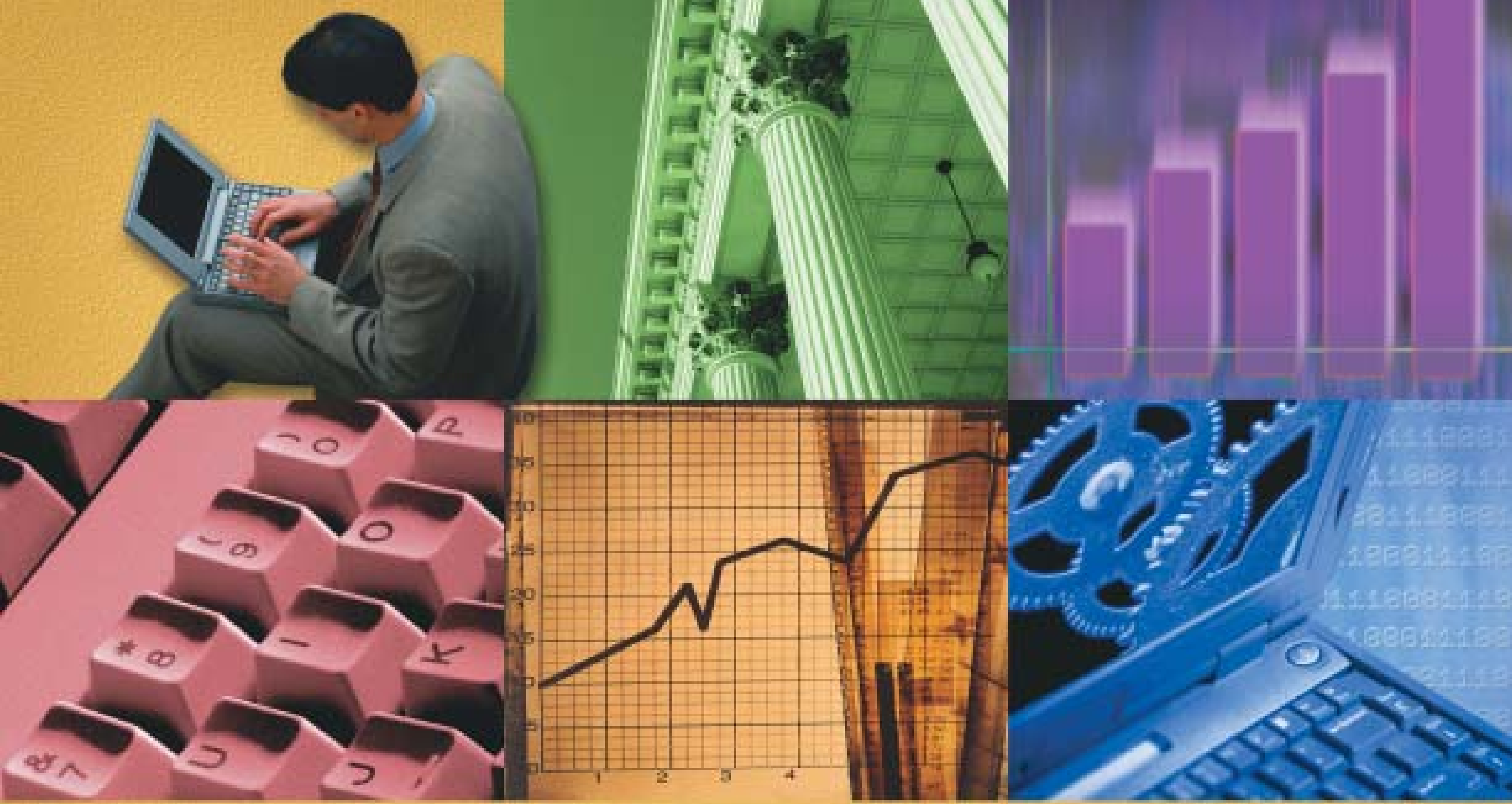

2002 ANNUAL REPORT

AgFirst Farm Credit Bank
and District Associations

AgFirst Farm Credit Bank and District Associations

2002 ANNUAL REPORT

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Management

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

Board of Directors

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

Message from the Chairman of the Board and Chief Executive Officer

Dear Shareholders:

For the third consecutive year, AgFirst Farm Credit Bank and its member-Associations posted record earnings. Although faced with many challenges, we ended the year with record profits of $312.5 million. Our loan portfolio grew at a healthy pace, and our credit quality remained high. Most importantly, we continued sharing our profits with our patrons, paying out more than $155 million in patronage refunds in 2002.

In many ways, 2002 was a particularly challenging year for Associations and their borrowers. Heavy rainfall at planting and harvest times and drought during the hot, summer months reduced yields in many parts of the District. The general economy was weak, and commodity prices remained relatively low. Low prices, coupled with the low yields, resulted in significant reductions in net farm income for some.

On the other hand, borrowers in the AgFirst District benefited from a very low interest rate environment in 2002. The Prime rate held steady at 4.75 percent throughout much of the year. In November 2002, it dropped even further to 4.25 percent, the lowest rate on record since 1958. Although Associations' profits were affected by the low rate environment, they continued paying strong patronage refunds. The combined effect of low rates and patronage refunds resulted in the lowest borrowing costs many borrowers have ever known.

The popularity of our patronage refund programs, strong marketing efforts and other factors fueled loan growth throughout the District in 2002. Association loan volume increased by 11 percent, or more than $1 billion. Some of this growth came as a result of reduced competition from other lenders. In the face of weakening economic conditions, commercial banks reduced their agricultural loan portfolios in 2002. By year-end, FDIC call report data confirmed that, for commercial banks headquartered in our District, ag loan volume had dropped more than 12 percent in 2002.

AgFirst and its affiliated Associations continue to focus on improving operating efficiencies. Credit Delivery, our new loan processing system, is now fully implemented in all twenty-four Associations, and loan officers report that it has made the job of analyzing and booking a loan much easier and faster. We will continue to enhance this product, and we'll introduce others, such as an online home loan application. As always, we'll seek solutions that will make our operations more efficient and, at the same time, make it easier for borrowers to do business with us.

Our District's success is the result of many factors, but one stands out among the rest. From Louisiana to Pennsylvania, from Ohio to Puerto Rico, our staffs and boards are dedicated to those they serve: farmers, ranchers, and others who live and work in rural America. This dedication is evident in all they do and in the excellent financial results they have produced. Because of them, we, indeed, have a proud heritage and a promising future.

Richard Kriebel

Richard Kriebel
Chairman of the Board

F. A. Lowrey

F. A. (Andy) Lowrey
Chief Executive Officer

February 19, 2003

Report of Management

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

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

The financial statements have been examined by independent public accountants, whose report appears elsewhere in this annual report. AgFirst and Associations are also subject to examination by the Farm Credit Administration.

The financial statements, in the opinion of management, fairly present the financial condition of AgFirst and Associations. The undersigned certify that the 2002 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.

Richard Kriebel

Richard Kriebel
Chairman of the Board

F. A. Lowrey

F. A. Lowrey
Chief Executive Officer

Leon T. Amerson

Leon T. Amerson
Chief Financial Officer

February 19, 2003

Five-Year Summary of Selected Combined Financial Data

(UNAUDITED)

	December 31,				
(dollars in thousands)	**2002**	**2001**	**2000**	**1999**	**1998**
Combined Balance Sheet Data					
Cash and cash equivalents	$ 444,457	$ 339,541	$ 326,204	$ 391,515	$ 378,447
Investment securities	2,153,118	1,663,323	2,000,086	2,101,764	1,627,010
Loans	13,823,089	12,877,889	11,095,176	10,164,673	9,894,875
Less: allowance for loan losses	311,180	301,615	284,867	278,953	269,906
Net loans	13,511,909	12,576,274	10,810,309	9,885,720	9,624,969
Other property owned	4,828	5,925	6,369	8,178	5,564
Other assets	312,689	376,630	379,453	338,962	350,797
Total assets	$ 16,427,001	$ 14,961,693	$ 13,522,421	$ 12,726,139	$ 11,986,787
Obligations with maturities of one year or less	$ 6,357,834	$ 8,101,242	$ 6,646,015	$ 6,191,236	$ 7,404,895
Obligations with maturities greater than one year	7,562,772	4,354,069	4,715,193	4,455,931	2,570,974
Total liabilities	13,920,606	12,455,311	11,361,208	10,647,167	9,975,869
Preferred Stock	225,839	225,839	—	—	—
Protected borrower equity	15,486	19,261	23,634	28,297	34,546
Capital stock and participation certificates	124,541	127,271	132,856	152,639	164,019
Retained earnings					
Allocated	756,525	733,378	704,010	659,297	620,678
Unallocated	1,494,659	1,393,592	1,302,163	1,249,773	1,197,760
Accumulated other comprehensive income (loss)	(110,655)	7,041	(1,450)	(11,034)	(6,085)
Total shareholders' equity	2,280,556	2,280,543	2,161,213	2,078,972	2,010,918
Total liabilities and equity	$ 16,427,001	$ 14,961,693	$ 13,522,421	$ 12,726,139	$ 11,986,787
Combined Statement of Income Data					
Net interest income	$ 553,058	$ 484,332	$ 440,656	$ 432,062	$ 426,495
Provision for loan losses	25,263	20,296	7,619	12,312	12,845
Noninterest income (expense), net	(215,248)	(160,795)	(198,460)	(201,571)	(195,233)
Net income	$ 312,547	$ 303,241	$ 234,577	$ 218,179	$ 218,417
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	2.04%	2.15%	1.85%	1.78%	1.90%
Total shareholders' equity	13.28%	13.67%	11.05%	10.63%	11.01%
Net interest income as a percentage of average earning assets	3.63%	3.46%	3.50%	3.56%	3.73%
Net chargeoffs (recoveries) to average loans	0.12%	0.03%	0.02%	0.03%	0.02%
Total shareholders' equity to total assets	13.88%	15.24%	15.98%	16.34%	16.78%
Debt to shareholders' equity (:1)	6.10	5.46	5.26	5.12	4.96
Allowance for loan losses to loans	2.25%	2.34%	2.57%	2.74%	2.73%
Permanent capital ratio (Bank only)	22.91%	20.70%	16.92%	18.86%	20.87%
Total surplus ratio (Bank only)	22.69%	19.86%	15.50%	16.72%	18.71%
Core surplus ratio (Bank only)	13.20%	10.39%	10.42%	10.89%	11.78%
Collateral ratio (Bank only)	105.94%	106.38%	104.95%	104.93%	105.07%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 64,846	$ 70,621	$ 61,185	$ 55,839	$ 60,375
Qualified allocated surplus	50,936	75,336	115,986	112,421	119,010
Nonqualified allocated surplus	42,261	29,946	4,634	—	—
Nonqualified retained surplus	32,402	21,165	—	—	—
Stock dividends	90	274	276	800	143
Preferred Stock Dividend	18,887	10,912	—	—	—

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

(dollars in thousands, except as noted)

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

Operating Structure

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

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

As of December 31, 2002, the District was comprised of AgFirst, its wholly owned subsidiary (the Farm Credit Finance Corporation of Puerto Rico), and twenty-four Agricultural Credit Associations (the Associations). AgFirst and the Farm Credit Finance Corporation of Puerto Rico provide funding and related services to the twenty-four Associations who, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the twenty-four Associations, a revolving line of credit, referred to as a *direct note*. Each Association funds its lending and general corporate activities by borrowing through its direct note. All assets of the Associations secure the direct notes and lending terms are specified in a separate General Financing Agreement between AgFirst and each Association. AgFirst also operates as a cooperative and is owned by the twenty-four Associations.

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

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

Results of Operations

Net Income

District net income totaled $312,547 for the year ended December 31, 2002, an increase of $9,306 over 2001, while 2001 income increased $68,664 over 2000. 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, 2002	2001
Net income (for prior year)	$ 303,241	$ 234,577
Increase (decrease) due to:		
Total interest income	(135,617)	(41,034)
Total interest expense	204,343	84,710
Net interest income	68,726	43,676
Provision for loan losses	(4,967)	(12,677)
Noninterest income	5,439	26,964
Noninterest expense	(36,298)	(16,672)
Provision for income taxes	(23,594)	27,373
Total increase (decrease) in net income	9,306	68,664
Net income	$ 312,547	$ 303,241

Interest Income

Total interest income for the year ended December 31, 2002 was $904,880, a decrease of $135,617 as compared to the same period of 2001. Total interest income for 2001 was $1,040,497, a decrease of $41,034 over the same period of 2000. The year-to-year decreases are primarily attributed to the decreasing rate environment seen during these periods; however, increases in average earning assets were significant in offsetting the impact of the rate environment.

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

	Year Ended December 31, 2002-2001	Year Ended December 31, 2001-2000
(dollars in thousands)		
Increase in average earning assets	$ 1,252,647	$ 1,380,590
Average yield (prior year)	7.44%	8.58%
Interest income variance attributed to change in volume	93,239	118,520
Average earning assets (current year)	15,231,566	13,978,919
Increase (decrease) in average yield	(1.50%)	(1.14%)
Interest income variance attributed to change in yield	(228,856)	(159,554)
Net change in interest income	$ (135,617)	$ (41,034)

Interest Expense

Total interest expense for the year ended December 31, 2002 was $351,822, a decrease of $204,343 as compared to the same period of 2001. Total interest expense for the year ended December 31, 2001 was $556,165, a decrease of $84,710 over 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 to support asset growth.

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 2002 totaled $18,887, compared to $11,751 in 2001.

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

	Year Ended December 31, 2002-2001	Year Ended December 31, 2001-2000
(dollars in thousands)		
Increase in average interest-bearing liabilities	$ 1,005,336	$ 1,149,016
Average rate (prior year)	4.85%	6.21%
Interest expense variance attributed to change in average interest-bearing liabilities	48,806	71,443
Average interest-bearing liabilities (current year)	12,461,494	11,456,158
Increase (decrease) in average rate	(2.03%)	(1.36%)
Interest expense variance attributed to change in rate	(253,149)	(156,153)
Net change in interest expense	$ (204,343)	$ (84,710)

Net Interest Income

Net interest income increased from 2000 to 2001 and from 2001 to 2002 as illustrated by the following table:

Analysis of Net Interest Income

	2002		2001		2000	
(dollars in thousands)	Avg. Balance	Interest	Avg. Balance	Interest	Avg. Balance	Interest
Loans	$ 13,283,343	$ 842,022	$ 11,845,091	$ 935,948	$ 10,351,962	$ 933,395
Cash & Investments	1,948,223	62,858	2,133,828	104,549	2,246,367	148,136
Total Earning Assets	$ 15,231,566	$ 904,880	$ 13,978,919	$ 1,040,497	$ 12,598,329	$ 1,081,531
Interest-Bearing Liabilities	$ 12,461,494	$ (351,822)	$ 11,456,158	$ (556,165)	$ 10,307,142	$ (640,875)
Impact of Capital	$ 2,770,072		$ 2,522,761		$ 2,291,187	
NET INTEREST INCOME		$ 553,058		$ 484,332		$ 440,656

	2002 Average Yield	2001 Average Yield	2000 Average Yield
Yield on Loans	6.34%	7.90%	9.02%
Yield on Cash & Investments	3.23%	4.90%	6.59%
Yield on Earning Assets	5.94%	7.44%	8.58%
Cost of Interest-Bearing Liabilities	2.82%	4.85%	6.22%
Spread	3.12%	2.59%	2.36%
Impact of Capital	.51%	.87%	1.14%
Net Interest Income/Avg. Earning Assets	3.63%	3.46%	3.50%

The year-to-year increases in net interest income were primarily due to increases in average earning assets, an improvement in spread, and the impact of preferred stock. The District's spread improved primarily due 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.

The improvement in spread was significantly offset by a decline in the impact of equity funding. Association equity is generally used to fund variable rate loans. As a result, falling interest rates have an adverse impact on Association net interest income approximately equal to the decline in rates times the volume of assets funded with Association equity.

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

Provision for Loan Losses

AgFirst and each Association assess risks inherent in their individual portfolios on an ongoing basis and establish an appropriate reserve for loan losses. The aggregate provision for loan losses totaled $25,263 in 2002 compared to $20,296 and $7,619 in 2001 and 2000, respectively. Despite recording a provision in each of the last three years, the ratio of allowance for loan losses to loans outstanding for 2000, 2001 and 2002 was 2.57 percent, 2.34 percent and 2.25 percent, respectively. The year-to-year decline in the allowance ratio is due primarily to loan growth.

Noninterest Income

Noninterest income for the year ended December 31, 2002 was $59,248, an increase of $5,439 compared to 2001 and $32,403 compared to 2000. The increase in 2002 is primarily due to gains on the sale of rural home loans to Fannie Mae totaling $14.3 million, which was offset by a decrease of $9.2 million in interest related to Association IRS refunds. The increase in noninterest income compared to 2000 was primarily due to increased loan fees, prepayment penalty income, and interest related to Association tax refunds.

Noninterest Expense

Noninterest expense for the year ended December 31, 2002 was $270,312, an increase of $36,298 over the same period of 2001 and $52,970 compared to 2000. The following table illustrates the sources of variance.

(dollars in thousands)	Year Ended December 31, 2002	2001
Prior Year Noninterest Expense	$ 234,014	$ 217,342
Change in Expense:		
Salaries and employee benefits	21,206	692
Occupancy and equipment	889	1,722
Intra-System financial assistance expense	1,313	(3,169)
Insurance Fund Premium	4,051	(99)
Realized losses on investments, net	(3,410)	4,798
Other operating expenses	6,788	3,408
Called debt expense	3,903	9,180
Miscellaneous	1,558	140
Noninterest Expense	$ 270,312	$ 234,014

Salaries and employee benefits have trended up over the two-year period. The substantial increase from 2001 to 2002 was heavily influenced by increasing benefits expense. Poor investment performance and lower discount rates resulted in substantially higher pension expense. Lower rates and increasing healthcare trends had a similar impact on post-retirement healthcare expense. AgFirst, along with other participating Associations, adopted changes to their respective benefits plans during 2002 in an effort to moderate future increases.

Intra-System financial assistance decreased from 2000 to 2001. In 2000, AgFirst recorded expenses related to calling Financial Assistance Corporation bonds. This extraordinary expense resulted in the high 2000 level (and resulting decrease in 2001). Expense increased from 2001 to 2002, largely the result of lower interest rates (which increased the present value of the obligations) and AgFirst's receiving a higher allocation of expense due to loan growth. See Note 12, *Intra-System Financial Assistance,* in the notes to the combined financial statements for further information

Despite the high-quality nature of its investment portfolio, AgFirst experienced an unusual loss during 2001 and 2002. 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 during 2001. During 2002, an additional $3.4 million was charged off for this investment, bringing its carrying value to zero. Subsequent to writing the security off, recoveries of $1.9 million were realized, resulting in a net chargeoff of $1.5 million during 2002.

Other operating expenses increased significantly from 2001 to 2002. The increase was primarily due to the following:

- ❖ During 2002, AgFirst incurred substantial purchased service expense related to a thorough review and revamping of its accounting processes in preparation of implementing new financial systems in the 2003 – 2004 timeframe.
- ❖ Farm Credit System Insurance Corporation (FCSIC) premiums increased in response to growth in System obligations. The FCSIC targets a secure base amount equal to 2 percent of System obligations. Growth throughout the System resulted in the secure base amount decreasing relative to obligations – leading to a premium increase from zero to 0.03 percent of loans outstanding. FCSIC expense is expected to increase substantially in 2003 as premiums move to 0.12 percent of loans outstanding.
- ❖ Furniture and equipment expenses increased as a result of a technology renovation aimed at improving the District's technical infrastructure and updating various systems.
- ❖ Unamortized concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. Falling interest rates enabled AgFirst to call a substantial amount of debt during 2002 and 2001, resulting in called debt expense of $13,518 and $9,615, respectively.

Provision for Income Taxes

Provision for income taxes increased in 2002 as the District Associations benefited from a greater tax recovery related to IRS tax settlements in 2001, resulting in a net tax benefit. Approximately $6 million dollars in tax refunds were recorded in 2002 compared to $34 million recognized in 2001. See Note 10, *Income Taxes*, for further details.

Financial Condition

Loans

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

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

(dollars in thousands)	2001 $	%
Association-originated loans	$ 11,171,874	87%
Loan participations purchased	2,462,130	19
Loan participations sold	(1,414,881)	(11)
Other	658,766	5
Total	$ 12,877,889	100%

(dollars in thousands)	2000 $	%
Association-originated loans	$ 10,018,099	90%
Loan participations purchased	1,899,377	17
Loan participations sold	(1,136,431)	(10)
Other	314,131	3
Total	$ 11,095,176	100%

Loans outstanding as of December 31, 2002 totaled $13,823,089, an increase of 7.34 percent and 24.59 percent compared to December 31, 2001 and 2000, respectively. The growth is consistent with trends in other Farm Credit System institutions and is attributed to a diverse agricultural economy, with income bolstered by significant government support for certain crops, commercial banks reducing their exposures to agriculture, and borrowers becoming increasingly aware of the value proposition inherent in Farm Credit's cooperative structure.

The District employs a number of risk management techniques to limit credit exposures. AgFirst and each Association have adopted underwriting standards, individual borrower hold limits, commodity hold limits, etc. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios and utilize guarantees from other agencies, including Fannie Mae, Farmer Mac, the Farm Services Agency, and the Small Business Administration. At December 31, 2002, the District collectively had $833.7 million under various government or GSE guarantee programs.

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

State	2002	2001	2000
North Carolina	17%	17%	17%
Florida	14	14	14
Georgia	11	12	12
Virginia	11	11	11
Pennsylvania	10	9	9
South Carolina	7	7	7
Maryland	6	6	6
Ohio	4	5	5
Alabama	3	3	3
Kentucky	2	2	2
Mississippi	2	2	2
Delaware	2	2	2
West Virginia	2	2	2
Puerto Rico	1	1	1
Louisiana	1	1	1
Tennessee	1	1	1
Other	6	5	5
Total	100%	100%	100%

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

Credit quality within the District portfolio remained relatively stable during the twelve months ending December 31, 2002. At year-end, the District's net loans were classified as follows:

	2002	2001	2000
Acceptable	92.18%	92.74%	90.96%
OAEM	5.22	4.84	6.64
Adverse	2.60	2.42	2.40
Total	100.00%	100.00%	100.00%

Delinquencies were 0.89 percent of total loan assets at year-end 2002 compared to 0.64 percent at year-end 2001. Nonearning assets for the District represented 0.86 percent of total loan assets or $118 million as of December 31, 2002, and 0.61 percent or $78 million as of December 31, 2001.

Net chargeoffs totaled $15.6 million and reflected a $12.2 million increase compared to the prior year-end. Essentially all of the chargeoffs are attributable to a single loan participated in by several Associations and AgFirst. As a percentage of the $13.8 billion in total loan assets, the net chargeoff for the District was only 0.11 percent.

Farm Credit System credit quality is an indirect beneficiary of government support as that support enables borrowers to honor their commitments. As a politically sensitive issue, analysts often question the dependability of government support and the impact that a reduction in support would have on agricultural lenders. However, 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 Associations. In addition, the diversified nature and significant non-farm influence on the District's portfolio mitigate the impact of lower government income support for program crops.

The diversity of income sources supporting loan repayment mitigates credit risk to the District. The District's credit portfolio is comprised of a number of segments having varying agricultural characteristics. The following table/chart illustrates the aggregate credit portfolio of the District by major commodity segment, which shows only six segments exceed five percent in commodity concentration.

	Percent of Portfolio		
Commodity Group	2002	2001	2000
Poultry	12%	13%	15%
Forestry	10	10	8
Grain	7	7	7
Cattle	7	7	8
Dairy	7	6	7
Rural Home	7	10	8
Nursery/Greenhouse	5	4	4
Citrus	4	4	3
Swine	4	4	6
Utilities	3	3	3
Tobacco	3	4	4
Cotton	3	3	3
Other	28	25	24
Total	100%	100%	100%

Loans $5 million or greater, which represents the commercial and corporate side of agribusiness, comprise approximately 4 percent of loan volume. Approximately 68 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $100 thousand make up 26 percent of loan volume. This diversification among borrowers is another key component of the District's stable credit quality and solid financial performance over time.

AgFirst and each Association maintain an allowance for loan losses determined by its management and is capitalized to serve its unique market. The following table illustrates the risk bearing capacity of the Associations.

	Permanent Capital Ratio	Core Surplus Ratio	Allowance/ Loans
High	25.03%	24.44%	3.56%
Mean	15.46%	11.27%	2.30%
Low	11.77%	8.04%	1.50%

Analysis indicates that an allowance for losses for AgFirst's direct note portfolio is not justified. All of AgFirst's allowance for losses reflect reserves for risks identified in the participations/syndications portfolio. Allowance for losses to AgFirst's participations/syndications outstanding was 1.91 percent, 1.65 percent and 1.56 percent at December 31, 2002, 2001, and 2000, respectively.

Liquidity and Funding Sources

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

Investments, Cash and Cash Equivalents

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

Cash and investment securities outstanding as of December 31, 2002 totaled $2.51 billion compared to $1.93 billion and $2.24 billion at December 31, 2001 and 2000, respectively. The increase is primarily attributed to efforts by AgFirst to increase its liquidity coverage.

AgFirst's investment portfolio consisted of the following security types as of December 31, 2002.

	$	%
Money Market Instruments	$ 603	24 %
Agency CMOs	950	38
Agency ARM Securities	811	33
Non-Agency Whole Loans	38	2
Commercial MBS	3	—
Asset-backed Securities	65	3
	$ 2,470	100 %

As illustrated, money market instruments (Fed Funds, Master Notes and Repos) represented 24 percent of the portfolio. U.S. Agency-guaranteed mortgage securities made up an additional 71 percent of the portfolio. The remaining 5 percent of the portfolio, while not Government or Agency-guaranteed, consists of highly rated, liquid securities.

AgFirst has adopted a liquidity policy that establishes a "minimum coverage" level. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2002, AgFirst's coverage was approximately 121 days.

Systemwide Debt Securities

The primary source of funds for AgFirst is the issuance of Systemwide debt securities through the Federal Farm Credit Banks Funding Corporation. At December 31, 2002, AgFirst had $13.5 billion in total debt outstanding compared to $12.1 billion at December 31, 2001 and $11.0 billion at December 31, 2000. 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

The District adheres to a philosophy that all loans should be priced competitively in the market and that loan rates and spreads should be contractually established at loan closing such that a borrower is not subject to rate changes at the discretion of management or boards of directors. Therefore, all District Association variable rate and adjustable rate loans are indexed to market rates, and fixed rate loans are priced based on market rates at closing. Loan products offered by the Associations include prime-indexed variable rate loans, LIBOR-indexed variable rate loans, one-, three- and five-year Treasury-indexed adjustable rate loans, and fixed rate loans. Variable rate and adjustable rate loans are offered with or without caps. Terms are available for up to 30 years. A variety of repayment options are offered, including fixed payment (standard amortization) and level principal payment (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.

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

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.

At December 31, 2002, AgFirst had outstanding interest rate swaps with notional amounts totaling $877.7 million and purchased interest rate caps with notional amounts totaling $1.76 billion. These derivative transactions were executed to reduce interest rate risk and/or reduce funding costs. The Associations do not participate in such derivative transactions.

AgFirst policy prohibits the use of derivatives for speculative purposes. Refer to Note 18, *Derivative Instruments and Hedging Activities,* and Note 19, *Additional Derivative Financial Instruments and Other Financial Instruments Disclosure,* in the notes to the combined financial statements for additional information.

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, 2002, the stock had accrued unpaid dividends totaling $839. AgFirst paid dividends in 2002 in the amount of $18,887 to preferred stock investors. See Note 8 of the notes to the combined financial statements of this annual report for more detailed information concerning the preferred stock issue.

Capital

Poor performance in the District's pension plan investments (which has been significantly impacted by a dismal stock market) coupled with declining discount rates used in determining the value of pension obligations led to the recognition of an *unfunded pension liability*. Recognition of the unfunded portion of pension obligations as a liability was offset by a charge to accumulated other comprehensive income (loss), which adversely impacted total shareholders' equity. Rising interest rates and/or improvement in investment performance could rapidly eliminate the current under-funded status of the plan. At December 31, 2002, the value of pension investments represented 74.2 percent of the accumulated pension obligation.

Excluding the impact of the accumulated other comprehensive income (loss), District capital continued its increasing trend, marked by an increase in retained earnings, offset somewhat by a decrease in stock.

Capital adequacy is evaluated using a number of ratios. For all periods presented, AgFirst and the Associations exceeded all minimum regulatory standards. Improvement in the AgFirst Bank-only permanent capital, total surplus, and core surplus ratios from December 31, 2001 to December 31, 2002 was primarily attributed to the accumulation of earnings, offset somewhat by asset growth.

Unlike the permanent capital, total surplus and core surplus ratios, the collateral ratio does not incorporate any risk-weighting of assets. The substantial growth in the direct note portfolio, which carries a 20 percent risk weighting in the three capital ratios, more than offset the accumulation of earnings, resulting in the slight decline in the collateral ratio from 2001 to 2002.

Refer to Note 9, *Shareholders' Equity*, in the notes to the combined 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 District institutions would be immaterial in relation to the financial position of the District. Refer to Note 15, *Commitments and Contingencies*, in the notes to the combined financial statements for additional information.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Description of Property

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

Location	Description
1401 Hampton Street	AgFirst 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 15 to the combined financial statements, *Commitments and Contingencies,* included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 to the combined 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, 12 and 15 to the 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, 2002, 2001 and 2000, is as follows:

Name of Individual or No. in Group	Year	Annual Salary	Annual Bonus	Total
F. A. (Andy) Lowrey	2002	$ 343,213	$ 102,964	$ 446,177
F. A. (Andy) Lowrey	2001	$ 312,648	$ 78,162	$ 390,810
F. A. (Andy) Lowrey	2000	$ 294,945	$ 73,736	$ 368,681
5 Officers	2002	$ 1,087,203	$ 289,658	$ 1,376,861
5 Officers	2001	$ 1,001,801	$ 233,532	$ 1,235,333
5 Officers	2000	$ 942,262	$ 201,102	$ 1,143,364

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 2002 bonus was made in the first quarter of 2003.

Disclosure of the total compensation in 2002 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, 2002)

Name	Position	Term of Office
Richard Kriebel	Chairman	December 31, 2003
Paul Lemoine	Vice Chairman	December 31, 2003
E. McDonald Berryman	Director	December 31, 2005
William C. Bess, Jr.	Director	December 31, 2005
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	August 6, 2002
Don W. Freeman	Director	December 31, 2005
Robert L. Holden, Sr.	Director	December 31, 2002
Paul M. House*	Director	December 31, 2003
Thomas W. Kelly	Director	December 31, 2004
M. Wayne Lambertson	Director	December 31, 2005
F. Merrel Lust	Director	December 31, 2005
Eugene W. Merritt, Jr.	Director	December 31, 2002
Dale W. Player	Director	December 31, 2003
J. Dan Raines, Jr.	Director	December 31, 2005
Walter L. Schmidlen, Jr.	Director	December 31, 2004
Robert G. Sexton	Director	December 31, 2003
Robert E. Strayhorn	Director	December 31, 2004

Richard Kriebel, 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** Farm Credit, ACA, and a former member of the Columbia County Extension and the Columbia County Planning Commission. During 2002, he served 29 days at AgFirst board meetings and 16 days at other official board functions, and was paid $25,368 in compensation.

Paul Lemoine, Vice Chairman of the Board, is a cattle and row crop farmer from Plaucheville, Louisiana, 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 2002, he served 29 days at AgFirst board meetings and 14 days at other official board functions, and was paid $25,368 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, soybeans, milo and sows, farrow to finish and 1,000 acres of growing timber. He also serves as President of Peanut Farmers LLC in Franklin, Virginia. During 2002, he served 29 days at AgFirst board meetings and 14 days at other official board functions, and was paid $25,368 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 2002, he served 26 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 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 2002, he served 26 days at AgFirst board meetings and 15 days at other official board functions, and was paid $25,368 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 2002, he served 20 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 in compensation.

Douglas L. Flory* resigned his position on the AgFirst Board effective August 6, 2002, to assume a seat on the Board of the Farm Credit Administration. During 2002 prior to his resignation, he served 14 days at AgFirst board meetings and 9 days at other official board functions, and was paid $14,167 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 2002, he served 26 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 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 2002, he served 26 days at AgFirst board meetings and 13 days at other official board functions, and was paid $25,368 in compensation.

Paul M. House* is from Nokesville, Virginia, where he farms 2,800 acres, raising corn, soybeans, wheat, hay and turf grass. He also operates a dairy, milking 300 cows. He serves as a director of the Farm Credit of the Virginias, ACA, is a member of the Virginia Farm Bureau and member/stockholder of Select Sires, Genex and Virginia State Dairymen's Association. During 2002, he served 6 days at AgFirst board meetings and 3 days at other official board functions, and was paid $2,238 in compensation. Mr. House was elected in October 2002 in a special election to fill the unexpired term of Douglas L. Flory.

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 *Ag***Choice** Farm Credit ACA. During 2002, he served 29 days at AgFirst board meetings and 18 days at other official board functions, and was paid $25,368 in compensation.

M. Wayne Lambertson of Pokomoke City, Maryland, owns and operates a 2,700-acre farm of corn, soybeans, and wheat, and a 300,000 capacity broiler operation. He currently serves on the MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization. He also serves on the board of the national Farm Credit Council. During 2002, he served 29 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 in compensation.

F. Merrel Lust is from Marion, Ohio, and grows corn, soybeans, and wheat on a 5,900-acre operation in partnership with his twin brother, his son and his nephew. He currently serves as a member of the board of Ag Credit ACA. During 2002, he served 26 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 15 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 16 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 18 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 13 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 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 2002, he served 29 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,368 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 $182,624 for 2002, $185,267 for 2001, and $159,655 for 2000. 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 $473,029 during 2002.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 13 to the combined financial statements, *Related Party Transactions,* included in this annual report to shareholders.

Involvement in Certain Legal Proceedings

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

Relationship with Independent Public Accountants

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

Combined Financial Statements

The combined financial statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 19, 2003, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Borrower Information Regulations

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

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

Shareholder Investment

Shareholder investment in a District Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 503, or writing Patti Trotter, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website at ***www.agfirst.com***.

Report of Independent Accountants

PRICEWATERHOUSECOOPERS

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

Report of Independent Accountants

February 19, 2003

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

We have audited the accompanying combined balance sheets of AgFirst Farm Credit Bank and District Associations as of December 31, 2002, 2001, and 2000, and the related combined statements of income, of changes in shareholders' equity, and of cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 combined financial statements referred to above present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank and District Associations at December 31, 2002, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Combined Balance Sheets

(dollars in thousands)	December 31, 2002	December 31, 2001	December 31, 2000
Assets			
Cash and cash equivalents	$ 444,457	$ 339,541	$ 326,204
Investment securities	2,153,118	1,663,323	2,000,086
Loans	13,823,089	12,877,889	11,095,176
Less: allowance for loan losses	311,180	301,615	284,867
Net loans	13,511,909	12,576,274	10,810,309
Accrued interest receivable	131,638	143,685	179,128
Investments in other Farm Credit System institutions	18,736	19,596	18,275
Premises and equipment, net	77,361	75,106	68,555
Other property owned	4,828	5,925	6,369
Other assets	84,954	138,243	113,495
Total assets	$16,427,001	$14,961,693	$13,522,421
Liabilities			
Bonds and notes	$13,538,536	$12,115,709	$11,014,557
Accrued interest payable	43,733	60,443	120,708
Dividends and patronage refunds payable	64,180	69,088	58,850
Minimum pension liability	61,822	—	—
Other liabilities	212,335	210,071	167,093
Total liabilities	$13,920,606	12,455,311	11,361,208
Commitments and contingencies (Note 15)			
Preferred Stock (Note 8)	225,839	225,839	—
Shareholders' Equity			
Protected borrower equity	15,486	19,261	23,634
Capital stock and participation certificates	124,541	127,271	132,856
Retained earnings			
Allocated	756,525	733,378	704,010
Unallocated	1,494,659	1,393,592	1,302,163
Accumulated other comprehensive income (loss)	(110,655)	7,041	(1,450)
Total shareholders' equity	2,280,556	2,280,543	2,161,213
Total liabilities and equity	$16,427,001	$14,961,693	$13,522,421

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

Combined Statements of Income

(dollars in thousands)	For the year ended December 31, 2002	2001	2000
Interest Income			
Investment securities and other	$ 62,858	$ 104,549	$ 148,136
Loans	842,022	935,948	933,395
Total interest income	904,880	1,040,497	1,081,531
Interest Expense	351,822	556,165	640,875
Net interest income	553,058	484,332	440,656
Provision for loan losses	25,263	20,296	7,619
Net interest income after provision for loan losses	527,795	464,036	433,037
Noninterest Income			
Loan fees	31,568	29,530	14,652
Fees for financially related services	5,077	6,052	5,500
Interest related to IRS refunds (Note 10)	2,865	12,094	—
Gain on sale of rural home loans	14,301	—	—
Miscellaneous	5,437	6,133	6,693
Total noninterest income	59,248	53,809	26,845
Noninterest Expenses			
Salaries and employee benefits	152,479	131,273	130,581
Occupancy and equipment	23,748	22,859	21,137
Insurance Fund premium	4,047	(4)	95
Other operating expenses	57,920	51,132	47,724
Intra-System financial assistance expenses	15,481	14,168	17,337
Realized losses on investments, net	1,388	4,798	—
Call debt expense	13,518	9,615	435
Miscellaneous	1,731	173	33
Total noninterest expenses	270,312	234,014	217,342
Income before income taxes	316,731	283,831	242,540
Provision (benefit) for income taxes	4,184	(19,410)	7,963
Net income	$ 312,547	$ 303,241	$ 234,577

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

Combined Statements of Changes in Shareholders' Equity

(dollars in thousands)	Preferred Stock	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 1999	$ —	$ 28,297	$ 152,639	$ 659,297	$ 1,249,773	$ (11,034)	$ 2,078,972
Comprehensive income							
Net income					234,577		234,577
Unrealized net gains on investments available for sale						9,584	9,584
Total comprehensive income							244,161
Protected borrower equity retired		(4,663)					(4,663)
Capital stock/participation certificates issued/retired, net			(20,059)				(20,059)
Dividends declared/paid			276		(1,822)		(1,546)
Patronage distribution							
Cash					(59,639)		(59,639)
Qualified allocated surplus				115,986	(115,986)		—
Nonqualified allocated surplus				4,634	(4,634)		—
Retained earnings retired				(76,365)			(76,365)
Patronage distribution adjustment				458	(106)		352
Balance at December 31, 2000	—	23,634	132,856	704,010	1,302,163	(1,450)	2,161,213
Comprehensive income							
Cumulative effect of a change in accounting for derivatives						(1,037)	(1,037)
Net income					303,241		303,241
Unrealized net gains on investments available for sale						12,588	12,588
Change in fair value of derivative instruments						(3,060)	(3,060)
Total comprehensive income							311,732
Preferred stock issued	225,000						225,000
Protected borrower equity retired		(4,373)					(4,373)
Capital stock/participation certificates issued/retired, net			(5,859)				(5,859)
Dividends declared/paid			274		(1,861)		(1,587)
Preferred stock dividends accrued	11,751				(11,751)		—
Preferred stock dividends paid	(10,912)						(10,912)
Patronage distribution							
Cash					(69,034)		(69,034)
Qualified allocated surplus				75,336	(75,336)		—
Nonqualified allocated surplus				29,946	(29,946)		—
Nonqualified retained surplus				21,165	(21,165)		—
Retained earnings retired				(98,923)			(98,923)
Patronage distribution adjustment				1,844	(2,719)		(875)
Balance at December 31, 2001	225,839	19,261	127,271	733,378	1,393,592	7,041	2,506,382
Comprehensive income							
Net income					312,547		312,547
Unrealized net gains on investments available for sale						6,856	6,856
Change in fair value of derivative instruments						(16,782)	(16,782)
Minimum pension liability						(107,770)	(107,770)
Total comprehensive income							194,851
Protected borrower equity retired		(3,775)					(3,775)
Capital stock/participation certificates issued/retired, net			(2,820)				(2,820)
Dividends declared/paid			90		(1,971)		(1,881)
Preferred stock dividends accrued	18,887				(18,887)		—
Preferred stock dividends paid	(18,887)						(18,887)
Patronage distribution							
Cash					(62,965)		(62,965)
Qualified allocated surplus				50,936	(50,936)		—
Nonqualified allocated surplus				42,261	(42,261)		—
Nonqualified retained surplus				32,402	(32,402)		—
Retained earnings retired				(105,217)			(105,217)
Patronage distribution adjustment				2,765	(2,058)		707
Balance at December 31, 2002	$ 225,839	$ 15,486	$ 124,541	$ 756,525	$ 1,494,659	$ (110,655)	$ 2,506,395

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

Combined Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2002	2001	2000
Cash flows from operating activities:			
Net income	$ 312,547	$ 303,241	$ 234,577
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	11,875	10,898	10,809
Provision for loan losses	25,263	20,296	7,619
(Gains) losses on other property owned, net	(377)	(387)	16
Realized losses on investments, net	1,388	4,798	—
Realized gains on mortgage loans held for sale	(14,301)	—	—
Proceeds from sale of mortgage loans held for sale	806,473	—	—
Purchase of mortgage loans held for sale (net of principal repayment)	(531,977)	(346,122)	(85,197)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	12,047	35,443	(28,142)
(Increase) decrease in investments in other Farm Credit System institutions	860	(1,321)	(1,353)
(Increase) decrease in other assets	53,289	(24,748)	(6,426)
Increase (decrease) in accrued interest payable	(16,710)	(60,265)	5,905
Increase (decrease) in other liabilities	(43,596)	43,025	11,878
Total adjustments	304,234	(318,383)	(84,891)
Net cash provided by operating activities	616,781	(15,142)	149,686
Cash flows from investing activities:			
Investment securities purchased	(3,040,275)	(2,346,707)	(1,977,974)
Investment securities sold or matured	2,555,948	2,691,260	2,089,236
Net increase in loans	(1,222,635)	(1,444,725)	(849,553)
Purchase of premises and equipment, net	(14,130)	(17,449)	(15,379)
Proceeds from sale of other property owned	2,928	5,370	4,388
Net cash used in investing activities	(1,718,164)	(1,112,251)	(749,282)
Cash flows from financing activities:			
Bonds and notes issued	49,737,367	44,526,761	25,714,904
Bonds and notes retired	(48,331,322)	(43,429,706)	(25,027,414)
Preferred stock issued	—	225,000	—
Protected borrower equity retired	(3,775)	(4,373)	(4,663)
Capital stock and participation certificates issued/retired, net	(2,820)	(5,859)	(20,059)
Patronage refunds and dividends paid	(69,047)	(61,258)	(52,118)
Dividends paid on preferred stock	(18,887)	(10,912)	—
Retained earnings retired	(105,217)	(98,923)	(76,365)
Net cash provided by financing activities	1,206,299	1,140,730	534,285
Net increase (decrease) in cash and cash equivalents	104,916	13,337	(65,311)
Cash and cash equivalents, beginning of period	339,541	326,204	391,515
Cash and cash equivalents, end of period	$ 444,457	$ 339,541	$ 326,204
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 3,553	$ 955	$ 2,426
Loans transferred to other property owned	5,095	5,541	4,968
Patronage refund and dividends payable	83,733	81,533	61,185
Change in unrealized gains (losses) on investments, net	(9,926)	12,588	9,584
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ (1,024)	$ 3,199	$ —
Increase (decrease) in bonds and notes	(8,478)	9,610	—
Decrease (increase) in other assets	9,328	(11,248)	—
Increase in other liabilities	561	5,734	—
Supplemental information:			
Interest paid	$ 368,532	$ 616,430	$ 634,970
Taxes paid, net	4,652	1,198	15,338
Federal tax refunds related to long-term lending operations (Note 10)	11,130	27,576	—

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

Notes to Combined Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

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

The nation is currently served by 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. AgFirst is chartered to service the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, the Commonwealth of Puerto Rico and portions of the states of Ohio, Tennessee, Kentucky and Louisiana.

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as Associations. AgFirst and its related associations (District Associations) are collectively referred to as the District. The District Associations and certain other financing institutions (OFIs) jointly own virtually all of AgFirst's stock. As of December 31, 2002, the District consisted of the Bank and twenty-four District ACAs. Effective January 1, 2003, twenty-two District Associations have restructured as holding companies, which include twenty-two FLCA and twenty-two PCA subsidiaries.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used 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 AgFirst and the District Associations.

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

The District Associations borrow from AgFirst and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members. As noted above, as of January 1, 2003, twenty-two ACAs have reorganized into parent-subsidiary structures and operate their long-term mortgage activities through FLCA subsidiaries and their short- and intermediate-term lending activities through PCA subsidiaries or the ACA.

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

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

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

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

Note 2 — Summary of Significant Accounting Policies

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

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

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

B. **Investment Securities:** The District, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The District's investments may not necessarily be held to maturity and accordingly have been classified as available for sale. 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 Combined Balance Sheets. Beginning January 1, 2001, the fair values of the related hedges are reported in other assets or other liabilities in the Combined Balance Sheets. Changes in the fair value of investments classified as available for sale and of the related hedges are reflected as direct charges or credits to shareholders' equity.

C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have maturities ranging from five to thirty years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of ten years or less. Loans are carried at their principal amount outstanding less unearned income adjusted for SFAS No. 133 valuation adjustments. Interest on loans is accrued and credited to interest income based upon the 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 chargeoff 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 chargeoffs 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 AgFirst or the Association 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, if material, 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 certain District Associations or by AgFirst because the effects are considered by management to not be material to their individual financial positions or results of operations or to the combined financial position or results of operations of the District.

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

E. **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.

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

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

G. **Advanced Conditional Payments:** The District Associations are authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance.

Advanced conditional payments are not insured. Interest is generally paid by the District Associations on such accounts.

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

The employees of the District are eligible to participate in the thrift/deferred compensation plan (Thrift Plan) of the District; a certain percentage of employee contributions is matched by the District. Thrift Plan costs are expensed as funded.

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

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

Effective January 1, 2003, twenty-two of the twenty-four District Associations have formed tax exempt subsidiaries as described in Note 1.

The PCAs and ACAs provide for Federal and certain other income taxes and are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Most District Associations operate as cooperatives under Subchapter T and can deduct from taxable income, amounts distributed as qualified patronage refunds to borrowers in the form of cash, stock or allocated retained earnings. Amounts distributed as nonqualified patronage refunds are tax deductible only when redeemed. Provisions for income taxes are made only on the earnings not distributed or not expected to be distributed as patronage refunds or are exempt from tax due to the long-term lending exemption. District Associations recognize deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. District Associations may provide a valuation allowance for deferred tax assets to the extent that it is more likely than not that they will not be realized.

At December 31, 2002, deferred income taxes have not been provided by certain District Associations on approximately $127 million of patronage refunds received prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. Under GAAP, deferred taxes must be provided on all patronage refunds made to taxable District Associations after December 31, 1992, except to the extent that a portion of these amounts will be distributed in the form of patronage to District Association members.

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

J. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. On January 1, 2001, the Bank adopted SFAS No. 133, as amended, which requires derivatives to be recorded on the balance sheet as assets and liabilities, measured at fair value. Prior to the adoption of SFAS No. 133, derivatives used for hedging purposes generally were not recorded on the balance sheet and the unrealized gains and losses were deferred on those accounts.

In accordance with SFAS No. 133, changes in the fair value of a derivative are recorded in current period earnings or accumulated other comprehensive income (loss) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions which hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative will generally be deferred and reported in accumulated other comprehensive income (loss). The gains and losses on the derivative that are deferred and reported in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

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

The Bank 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.

Note 3 — Investment Securities

A summary of the amortized cost and fair value of debt securities held as investments at December 31, 2002, 2001 and 2000, is as follows:

	December 31, 2002				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
U.S. Agency-backed ARM securities	$ 816,230	$ 18,109	$ (16)	$ 834,323	4.59%
Collateralized mortgage obligations	993,620	2,978	(2,942)	993,656	2.55
Other asset-backed securities	65,467	6	(153)	65,320	1.72
CDs, commercial paper and other	259,807	13	(1)	259,819	1.51
Total Investment Securities	$ 2,135,124	$ 21,106	$ (3,112)	$ 2,153,118	3.17%

	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%

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2002, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ 259,807	$ 259,819	1.48%
After one year through five years	6,431	6,433	2.46
After five years through ten years	—	—	—
After ten years	875,266	893,210	3.60
Collateralized mortgage obligations	993,620	993,656	2.55
Total	$ 2,135,124	$ 2,153,118	3.17%

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,		
	2002	2001	2000
Proceeds on sales	$ 92,510	$ 460,356	$ —
Realized gains	2,035	3,299	—
Realized losses	3,423	8,097	—

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2002	2001	2000
Long-term farm mortgage	$ 5,813,020	$ 4,177,711	$ 3,994,162
Production and intermediate-term	5,365,864	5,931,092	5,055,079
Rural home	939,943	1,259,996	912,740
Farm-related business	178,773	150,404	114,242
Utility	403,169	384,034	312,625
Basic processing and marketing	235,822	224,454	170,444
Sales contracts/purchase money mortgage	15,103	16,611	20,974
Plus: Participations purchased	2,303,883	1,967,029	1,585,566
Less: Participations sold	(1,565,235)	(1,414,881)	(1,136,431)
Other	132,747	181,439	65,775
Total	$ 13,823,089	$ 12,877,889	$ 11,095,176

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

Total loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	**2002**	**2001**	**2000**
Poultry	12%	13%	15%
Forestry	10	10	8
Rural home	7	10	8
Cattle	7	7	8
Grain	7	7	7
Dairy	7	6	7
Swine	4	4	6
Nursery/Greenhouse	5	4	4
Tobacco	3	4	4
Citrus	4	4	3
Cotton	3	3	3
Utilities	3	3	3
Other	28	25	24
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 following table presents information relating to impaired loans.

	December 31, 2002	2001	2000
Nonaccrual:			
Current as to principal and interest	$ 50,431	$ 27,173	$ 34,751
Past due	63,223	45,136	31,974
Accrual:			
Restructured	5,354	7,296	10,786
90 days or more past due	9,720	9,736	4,549
Total impaired loans	$ 128,728	$ 89,341	$ 82,060

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2002.

Interest income recognized on nonaccrual loans totaled $9,927, $10,652, and $15,562 in 2002, 2001 and 2000, respectively. In 2002, this amount consisted of $1,631 of interest income recognized on transfer to accrual status, while $8,294 consisted of cash payments on nonaccrual loans qualifying for income recognition.

The average recorded investment in impaired loans during 2002, 2001 and 2000 was $124,274, $83,149, and $90,898, respectively. Impaired loans of $9,899, $11,056, and $10,598 at December 31, 2002, 2001 and 2000 had a related specific allowance for loan losses totaling $10,671, $5,026, and $6,549, respectively. The District recognized interest income on impaired loans of $11,801, $12,445, and $18,849 in 2002, 2001 and 2000, respectively.

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

	Year Ended December 31, 2002	2001	2000
Balance at beginning of year	$ 301,615	$ 284,867	$ 278,953
Provision for (reversal of) loan losses	25,263	20,296	7,619
Loans charged off	(17,283)	(4,896)	(2,795)
Recoveries	1,585	1,348	1,090
Balance at end of year	$ 311,180	$ 301,615	$ 284,867

To mitigate the risk of loans being placed in nonaccrual status, System institutions may enter into long-term standby commitments to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Bank or Association the right to sell the loans identified in the agreements to Farmer Mac in the event a delinquency of four months occurs. The balance of loans under long-term standby commitments was $411 million and $191 million at December 31, 2002 and 2001, respectively. Fees paid to Farmer Mac for such commitments totaled $1.6 million and $311 thousand for the years ended December 31, 2002 and 2001, respectively. These amounts are classified as noninterest expense.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2002	2001	2000
Land	$ 12,034	$ 11,919	$ 11,390
Buildings and improvements	67,017	64,368	64,270
Furniture and equipment	74,837	69,340	69,830
	153,888	145,627	145,490
Less: accumulated depreciation	76,527	70,521	76,935
Total	$ 77,361	$ 75,106	$ 68,555

Note 6 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31, 2002	2001	2000
Other assets:			
Prepaid pension costs	$ 9,800	$ 58,700	$ 49,795
Net deferred tax asset	13,761	23,981	31,711
Derivative assets	1,920	11,248	—
Unamortized debt issue costs	7,168	5,494	4,438
Deferred preferred stock cost	2,331	2,608	—
Intangible asset related to pension	1,980	—	—
Prepaid expenses	600	501	204
Receivables and other	47,394	35,711	27,347
Total	$ 84,954	$ 138,243	$ 113,495
Other liabilities:			
Other postretirement benefits liability	$ 67,192	$ 60,316	$ 54,255
Minimum pension liability	61,822	—	—
Accounts payable	21,111	24,715	22,591
Financial Assistance Corporation payable	8,795	9,644	10,826
Derivative liabilities	6,295	5,734	—
Farm Credit System Ins. Corp. payable	4,047	—	114
Bank draft payable	64,861	54,614	53,315
Other	40,034	55,048	25,992
Total	$ 274,157	$ 210,071	$ 167,093

Note 7 — Bonds and Notes

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued by the Banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide debt securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets, at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide debt securities with a security interest in any assets of the banks. In 1994, the System banks and the Funding Corporation entered into the Market Access Agreement (MAA), which established criteria and procedures for the banks to provide certain information and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. At December 31, 2002, AgFirst was and currently remains in compliance with the conditions of participation for the issuances of Systemwide debt securities.

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

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

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

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

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

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

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

	Bonds		Medium-Term		Discount Notes		Total	
	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount
2003	1.65%	$ 4,484,915	5.58%	$ 15,000	1.57%	$ 1,612,089	1.64%	$ 6,112,004
2004	1.83	3,491,476	—	—	—	—	1.83	3,491,476
2005	2.53	1,492,113	—	—	—	—	2.53	1,492,113
2006	3.35	688,869	—	—	—	—	3.35	688,869
2007	3.64	709,777	—	—	—	—	3.64	709,777
2008	4.82	1,045,230	—	—	—	—	4.82	1,045,230
Total	2.33%	$ 11,912,380	5.58%	$ 15,000	1.57%	$ 1,612,089	2.24%	$ 13,539,469

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

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2002, was 117 days.

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

Amount	First Call Date	Year of Maturity
$ 4,406,000	2003	2003-2017
5,000	2004	2012
$ 4,411,000		

Callable debt may be called on the first call date and, generally, on each interest payment date thereafter.

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide debt securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund; all other liabilities on the financial statements are uninsured. At December 31, 2002 the assets of the Insurance Fund aggregated $1.839 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal of or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund will be used to repay, 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, 2002, available funds in the Trust Fund amounted to $131.0 million.

The District had no committed commercial bank lines of credit at December 31, 2002.

Note 8 — Mandatorily Redeemable Preferred Stock

As of December 31, 2002, AgFirst had 225,000 shares issued and outstanding of mandatorily redeemable cumulative preferred stock at $1,000.00 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 $1,000.00 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 $1,000.00 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 District's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Protected Borrower Equity**

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

B. **Capital Stock, Participation Certificates and Retained Earnings**

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

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

District Associations:

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

The District Associations had the following shares outstanding at December 31, 2002:

		Shares Outstanding	
Class	**Protected Status**	**Number**	**Aggregate Par Value**
A Common Nonvoting	Yes	145,400	$ 727
A Common Nonvoting	No	220,000	1,100
B Common Nonvoting	Yes	2,678,400	13,392
B Common Nonvoting	No	—	—
B Common Voting	No	1,032,800	5,164
C Common Voting	No	16,440,400	82,202
B Participation Certificates	Yes	273,400	1,367
C Participation Certificates	No	2,070,800	10,354
Participation Certificates	No	—	—
A Preferred	No	2,616,600	13,083
C Preferred	No	43,600	218
Total Association Capital Stock and Participation Certificates		25,521,400	$ 127,607

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

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

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

Retained Earnings

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

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

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

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2002, combined allocated retained earnings consisted of $600,675 of qualified surplus, $89,370 of nonqualified allocated surplus and $66,480 of nonqualified retained surplus.

Dividends

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

Patronage Distributions

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

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

Amounts not distributed are retained as unallocated retained earnings.

Transfer

Equities may generally be transferred to persons or entities eligible to purchase or hold such equities.

Impairment

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

Liquidation

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

AgFirst:

Capital stock and allocated retained earnings — District Associations are required to invest in the capital stock of AgFirst. In addition, AgFirst has allocated, but not distributed, a portion of its retained earnings to the District Associations. These intercompany balances and transactions are eliminated in combination. Additionally, AgFirst has issued and has outstanding $11,577 in Class D Common stock which is a nonvoting class of stock with a $5.00 par value.

Other Equity — At the inception of each OFI loan, AgFirst requires OFIs to make cash purchases of participation certificates in AgFirst. In addition, OFIs receive participation certificates and allocated retained earnings from AgFirst's distribution of net income on a percentage basis. AgFirst has a first lien on these equities for the repayment of any indebtedness to AgFirst. At December 31, 2002, AgFirst had $663 of participation certificates outstanding to OFIs at a face value of $5.00 per share.

Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require AgFirst and District Associations to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on AgFirst's or District Associations' financial statements. AgFirst and District Associations are prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA regulations also require that additional minimum capital standards be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The following table shows the approximate ranges of capital standards for the entities within the District at December 31, 2002.

	Permanent Capital Ratio Ranges	Core Surplus Ratio Ranges	Total Surplus Ratio Ranges
AgFirst	22.91%	13.20%	22.69%
District Associations	12% – 25%	8% – 24%	10% – 24%

Subsequent to the issuance of the preferred stock, FCA now requires AgFirst to maintain a minimum collateral ratio of 104 percent compared to the standard regulatory minimum of 103 percent. At December 31, 2002, AgFirst's net collateral ratio was 105.94 percent.

Included in the above table as of December 31, 2002, are twenty-one Associations that have reorganized through the creation of FLCA and PCA subsidiaries. These subsidiaries and the ACA operate under a common board of directors and joint management. As a result, these District Associations are jointly obligated on each other's liabilities and are evaluated on a consolidated basis for capital adequacy and other regulatory purposes. Effective January 1, 2003, one additional District Association also reorganized as a parent-subsidiary structure.

All District entities were in compliance with the required minimum capital standards at December 31, 2002.

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. AgFirst and District Associations have not been called upon to initiate any transfers and are not aware of any proposed action under this regulation.

Note 10 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2002	2001	2000
Current:			
Federal	$ 225	$ 5,466	$ 9,483
State	(427)	1,397	1,519
ACA tax refunds	(5,834)	(34,003)	—
	(6,036)	(27,140)	11,002
Deferred:			
Federal	3,664	(1,731)	(3,113)
State	(379)	(62)	74
Write-off deferred tax assets	6,935	9,523	—
	10,220	7,730	(3,039)
Total provision (benefit) for income taxes	$ 4,184	$ (19,410)	$ 7,963

In connection with the restructuring previously discussed, deferred tax assets of $6,935 and $9,523 relating to the corporate restructuring and long-term lending activities were written off during 2002 and 2001, respectively, to reflect the change in tax status. Additionally, from 2000 through 2002, Associations signed settlement agreements with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities. This settlement agreement was modeled after one used by another System ACA to reach a settlement agreement with the IRS in August 2000. As a result of this settlement, the Associations recorded tax refunds of $5,835 and $34,003 in 2002 and 2001, respectively, which is included as a component of the 2002 and 2001 current income tax provision. In addition, the Associations recorded $2,865 and $12,094 in interest related to these refunds in 2002 and 2001, respectively, which is included in noninterest income in the accompanying Combined Statements of Income.

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

	Year Ended December 31, 2002	2001	2000
Federal tax at statutory rate	$ 107,580	$ 96,503	$ 82,464
State tax, net	74	1,150	1,593
Tax-exempt FLCA earnings	(40,676)	(27,971)	—
Association patronage distributions	(35,223)	(45,163)	(61,180)
Nontaxable Bank income	(29,004)	(21,198)	(9,996)
Possessions credit (Puerto Rico)	(690)	(1,046)	(1,135)
ACA tax refunds	(5,834)	(34,003)	—
Write-off of deferred tax assets	6,935	9,523	—
Other	1,022	2,795	(3,783)
Provision for income taxes	$ 4,184	$ (19,410)	$ 7,963

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

	December 31, 2002	2001	2000
Allowance for loan losses	$ 21,712	$ 24,941	$ 26,881
Annual leave	162	638	1,061
Nonaccrual loan interest	1,579	2,162	3,526
Postretirement benefits other than pensions	1,259	3,738	5,002
Financial assistance payable	198	198	224
Nonqualified patronage distributions	13,897	11,827	13,042
Other	1,738	1,496	1,318
Gross deferred tax asset	40,545	45,000	51,054
Deferred tax asset valuation allowance	(15,577)	(6,515)	(1,050)
Future Bank stock redemptions	(3,442)	(3,609)	(4,495)
Bank patronage	(4,284)	(4,515)	(5,542)
State income tax	(802)	(751)	(714)
Loan fees	(1,602)	(1,978)	(2,457)
Pensions	(939)	(3,061)	(4,194)
Depreciation	(104)	(169)	(276)
Other	(34)	(421)	(615)
Gross deferred tax liability	(11,207)	(14,504)	(18,293)
Net deferred tax asset	$ 13,761	$ 23,981	$ 31,711

At December 31, 2002, deferred income taxes have not been provided by District Associations on approximately $127 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

Note 11 — Employee Benefit Plans

There are three defined benefit plans within the District. The first plan (the District Plan) covers employees of nineteen Associations and AgFirst. The second plan covers employees of four ACAs, and the third plan covers employees of a single ACA. Each Plan is noncontributory and covers substantially all employees of the participating entities. Benefits are based on salary and years of service.

At December 31, 2002, the Accumulated Benefit Obligation (ABO) of the District's defined benefit plan exceeded the fair value of plan assets by $61,822. In accordance with the provisions of SFAS No. 87, *"Employers' Accounting for Pensions"*, (SFAS No. 87), the recognition of a minimum liability in the amount of the excess of the ABO over the fair value of plan assets is required. At December 31, 2002, a minimum liability for the Bank and the Associations that participate in the District plan of $61,822 was recognized. In conjunction with the minimum liability, a reduction in other comprehensive income (loss) of $107,770 and an increase in intangible assets of $1,980 were recorded. The impact on deferred taxes was not significant.

The measurement date for the assets and liabilities of the pension and postretirement health care plans is September 30.

The following tables set forth the continued funding status and activity of the retirement plans:

	As of December 31, 2002	2001	2000
Benefit obligations	$ 324,397	$ 281,348	$ 241,090
Fair value of plan assets	214,702	236,444	300,831
Funded status	$ (109,695)	$ (44,904)	$ 59,741
Prepaid benefit cost or (accrued pension liability) recognized in the Balance Sheet	$ (52,022)	$ 58,700	$ 49,795
Weighted-average assumptions:			
Discount rate	6.75%	7.50%	7.17%
Expected return on plan assets	8.87%	9.00%	9.00%
Rate of compensation increase	4.04%	4.00%	4.00%

	2002	2001	2000
Benefit cost	$ 13,612	$ 1,891	$ 5,785
Employer contributions	12,239	10,293	11,088
Benefits paid	18,510	16,386	19,305

The District also participates in a Districtwide defined contribution Thrift Plan. The Thrift Plan requires AgFirst and Associations to match a percentage of employee contributions up to a maximum employee contribution of 6 percent of total compensation. Employer contributions were $3,318, $3,065, and $2,977 for 2002, 2001 and 2000, respectively.

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

The following tables set forth the combined funding status and activity of the other postretirement benefits:

	As of December 31, 2002	2001	2000
Benefit obligations	$ 137,442	$ 97,841	$ 76,922
Fair value of plan assets	194	207	665
Funded status	$ (137,248)	$ (97,634)	$ (76,257)
Prepaid (accrued) benefit cost recognized in the Balance Sheet	$ (67,172)	$ (60,316)	$ (54,255)
Weighted-average assumptions			
Discount rate:			
- Fiscal Year expense determination	7.50%	8.00%	8.00%
- Funded status at year-end and subsequent year expense determination	6.75%	7.50%	8.00%
Expected return on plan assets	8.00%	9.00%	9.00%

	2002	2001	2000
Benefit cost	$ 12,293	$ 10,656	$ 10,344
Contributions to plan	5,386	4,509	3,952
Benefits paid	5,416	5,020	4,007

The assumed health care cost trend rates used in measuring the accumulated postretirement benefit obligation for the medical plans for participants aged less than 65 are 10 percent for 2002 and 9 percent for 2003, declining gradually to 5 percent in 2008 and remaining at that level thereafter. For those participants aged greater than 65, the assumed health care cost trend rates are 12 percent for 2002 and 11 percent for 2003, declining gradually to 5 percent in 2011 and remaining at that level thereafter.

Note 12 — Intra-System Financial Assistance

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

The proceeds from the debt offerings were used to fund existing intra-System financial assistance payables ($417 million), to purchase preferred stock from certain troubled System banks ($808 million), and for other purposes ($36 million). Pursuant to the Farm Credit Act, the U.S. Treasury paid the interest on $844 million of the Financial Assistance Corporation bonds for the first five years of the respective terms of such bonds. The payment of interest on this debt 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 AgFirst under the System's Capital Preservation Agreements and funded payment of such accruals by the issuance of 15-year U.S. Treasury-guaranteed debt. Under the Farm Credit Act, the System banks are required to fund the bonds upon maturity. Although GAAP requires recognition in the financial statements of AgFirst's liability to the Financial Assistance Corporation, the Farm Credit Act states that, for all financial reporting purposes, this obligation shall not be considered a liability of any System bank until the maturity of such debt. 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 AgFirst's financial condition and results of operations.

In 1998, AgFirst 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. AgFirst expensed $5.9 million in 1998, related to the calling of the $240 million issuance, and $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 $89.1 million issuance, representing its pro rata shares of the additional funding required.

The District's financial assistance expense totaled $15 million, $14 million and $17 million in 2002, 2001 and 2000, respectively.

Note 13 — Related Party Transactions

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

Total loans to such persons at December 31, 2002, amounted to $193,146. During 2002, $132,290 of new loans were made and repayments totaled $105,683. In the opinion of management, no material amounts outstanding at December 31, 2002, involved more than a normal risk of collectibility.

Note 14 — Regulatory Enforcement Matters

At December 31, 2002, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 15 — Commitments and Contingencies

The District has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to combined financial statements. While primarily liable for its portion of bonds and notes, AgFirst is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2002 were $89.1 billion.

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

Note 16 – Financial Instruments with Off-Balance-Sheet Risk

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

Standby letters of credit are unconditional commitments issued by the Bank and District Associations to guarantee the performance of a customer to a third party. As of December 31, 2002, the Bank had $37 million in letters of credit with non-District entities with $13.8 million expiring in less than one year, $20 million due to expire in one to three years and the remaining $3.2 million have terms that will expire from 2007 to 2011. As of December 31, 2002, the District Associations had $29 million in letters of credit with terms predominantly of one to three years. The notional amounts of these guarantees represent the maximum amount of exposure the Bank and the District Associations have related to these instruments as of December 31, 2002.

At December 31, 2002, $2.4 billion of commitments to extend credit were outstanding. Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the loan collateral is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

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 $131.5 million. AgFirst also indemnifies leases in the amount of $4.7 million on behalf of FCLSC with lease terms expiring in 2009.

Note 17 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the District's financial instruments at December 31, 2002, 2001 and 2000. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market prices are generally not available for certain System financial instruments, as described below.

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

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

	December 31, 2002		December 31, 2001		December 31, 2000	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$ 13,823,089	$ 14,184,579	$ 12,877,889	$ 13,007,140	$ 11,095,176	$ 11,127,840
Allowance for loan losses	(311,180)	—	(301,615)	—	(284,867)	—
Loans, net	$ 13,511,909	$ 14,184,579	$ 12,576,264	$ 13,007,140	$ 10,810,309	$ 11,127,840
Other assets**	$ 1,920	$ 1,920	$ 11,248	$ 11,248	$ —	$ —
Cash & investment securities	$ 2,597,575	$ 2,597,575	$ 2,002,864	$ 2,002,864	$ 2,329,703	$ 2,329,703
Related interest rate swaps	—	—	—	—	(3,413)	(3,413)
Net cash & investment securities	$ 2,597,575	$ 2,597,575	$ 2,002,864	$ 2,002,864	$ 2,326,290	$ 2,326,290
Financial liabilities:						
Systemwide debt securities	$ 13,538,536	$ 13,584,445	$ 12,115,709	$ 12,134,913	$ 11,014,557	$ 11,032,565
Financial assistance related liabilities*	$ 8,795	$ 12,095	$ 9,644	$ 13,536	$ 10,826	$ 14,682
Other liabilities**	$ 6,295	$ 6,295	$ 5,734	$ 5,734	$ —	$ —

* *The above amount excludes the assumption of Third Quarter 1986 Capital Preservation Agreement obligations with a fair value of $6.8 million at December 31, 2002.*
** *Due to the adoption of SFAS No. 133, derivative financial instruments are recorded on the Balance Sheet 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 12, the District is liable for certain obligations of the Financial Assistance Corporation, one of which is unrecorded. Fair value of these obligations is determined by discounting the cumulative expected future cash outflows of all of the obligations using an interest rate commensurate with bonds having a similar maturity.

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

G. **Commitments to Extend Credit and Standby Letters of Credit:** The fair value of commitments is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreement and the creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on an estimate of the cost to terminate the agreement or fees currently charged for similar agreements.

Note 18 — Derivative Instruments and Hedging Activities

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

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

The District may purchase interest rate options such as caps, in order to reduce the impact of rising interest rates on 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 District's purchased caps qualify for hedge accounting treatment. There are no floors outstanding currently.

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

To minimize the risk of credit losses, the Bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitor the credit standing of and levels of exposure to individual counterparties. Transactions with six counterparties represent approximately .33 percent of the total notional amount of interest rate swaps. The Bank does not anticipate nonperformance by any of these counterparties. The Bank typically enters into master agreements that contain netting provisions. These provisions allow the Bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. A number of swaps are supported by collateral arrangements with counterparties. At December 31, 2002, the Bank had not posted collateral with respect to these arrangements.

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

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

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

December 31, 2002 *(dollars in millions)*	**Maturities of 2002 Derivative Products** 2003	2004	2005	2006	2007	After 2008	Total	Fair Value
Long-term Debt Obligations:								
Fixed rate	$ 3,506	$ 1,465	$ 1,072	$ 591	$ 610	$ 1,045	$ 8,289	$ 8,230
Weighted average interest rate	1.83%	2.56%	3.00%	3.69%	4.01%	4.82%	2.80%	
Variable rate	2,425	2,026	420	98	100	—	5,069	5,173
Weighted average interest rate	1.39%	1.30%	1.35%	1.37%	1.36%	—	1.35%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 118	$ 75	$ —	$ —	$ —	$ —	$ 193	$ 195
Weighted average receive rate	2.11%	2.48%	—	—	—	—	2.25%	
Weighted average pay rate	1.46%	1.27%	—	—	—	—	1.39%	
Amortizing floating for floating swaps								
Notional value	—	90	255	339	—	—	684	678
Weighted average receive rate	—	3.35%	2.19%	2.28%	—	—	2.39%	
Weighted average pay rate	—	5.38%	3.31%	2.32%	—	—	3.09%	
Other derivative products								
Notional value — Interest rate caps	—	1,384	378	—	—	—	1,762	1,769
Total notional value	$ 118	$ 1,549	$ 633	$ 339	$ —	$ —	$ 2,639	$ 2,642
Total weighted average rates on swaps:								
Receive rate	2.11%	2.95%	2.19%	2.28%	—%	—%	2.36%	
Pay rate	1.46%	3.51%	3.31%	2.32%	—%	—%	2.72%	

(dollars in millions)	Less than 1 year	1 to 5 Years	Over 5 Years	Maturity Distribution Netting	Exposure	Collateral Held	Exposure Net of Collateral
Credit Rating							
AAA	$ —	$ —	$ —	$ —	$ —	$ —	$ —
AA	—	—	6	(4)	2	—	2
A	—	—	2	(2)	—	—	—
Total	$ —	$ —	$ 8	$ (6)	$ 2	$ —	$ 2

Note 20 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2002, 2001 and 2000 follow:

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

2001	First	Second	Third	Fourth	Total
Net interest income	$ 113,130	$ 117,468	$ 121,752	$ 131,982	$ 484,332
Provision for loan losses	2,792	3,771	4,518	9,215	20,296
Noninterest income (expense), net	(45,841)	(38,486)	(50,076)	(45,802)	(180,205)
Cumulative effect of a change in accounting principle	(112)	—	112	—	—
(Provision) benefit for income taxes	(1,324)	3,900	7,623	9,211	19,410
Net income	$ 63,061	$ 79,111	$ 74,893	$ 86,176	$ 303,241

2000	First	Second	Third	Fourth	Total
Net interest income	$ 107,334	$ 108,235	$ 111,846	$ 113,241	$ 440,656
Provision for loan losses	839	1,227	2,676	2,877	7,619
Noninterest income (expense), net	(48,855)	(47,027)	(46,629)	(47,986)	(190,497)
(Provision) benefit for income taxes	(3,151)	(3,972)	531	(1,371)	(7,963)
Net income	$ 54,489	$ 56,009	$ 63,072	$ 61,007	$ 234,577

Note 21 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

December 31,	2002	2001	2000
Cash, cash equivalents and investment securities	$ 2,512,937	$ 1,928,577	$ 2,241,674
Loans			
to District Associations	10,033,923	8,916,205	7,807,248
to Others	1,974,118	2,212,605	1,689,255
Total Loans	12,008,041	11,128,810	9,496,503
Less: allowance for loan losses	31,155	25,616	21,416
Net loans	11,976,886	11,103,194	9,475,087
Other assets	211,367	201,634	197,338
Total assets	$ 14,701,190	$ 13,233,405	$ 11,914,099
Bonds and notes	$ 13,538,536	$ 12,115,709	$ 11,014,557
Other liabilities	179,970	163,909	211,768
Total liabilities	13,718,506	12,279,618	11,226,325
Preferred stock	225,839	225,839	—
Capital stock and participation Certificates	249,444	281,803	301,189
Retained earnings	527,673	439,104	388,035
Accumulated other comprehensive income (loss)	(20,272)	7,041	(1,450)
Total shareholders' equity	756,845	727,948	687,774
Total liabilities and equity	$ 14,701,190	$ 13,233,405	$ 11,914,099

Statement of Income

Year Ended December 31,	2002	2001	2000
Interest income	$ 607,411	$ 740,637	$ 775,601
Interest expense	351,751	555,855	640,437
Net interest income	255,660	184,782	135,164
Provision for loan losses	8,000	4,500	2,500
Net interest income after provision for loan losses	247,660	180,282	132,664
Noninterest income	25,659	13,509	6,631
Noninterest expenses			
Salaries and employee benefits	22,507	17,515	16,191
Occupancy and equipment	7,966	7,147	6,232
Insurance Fund Premium	4,047	(2)	11
Other operating expenses	11,938	9,791	8,996
Call Debt Expense	13,518	—	—
Intra-System financial assistance expenses	15,458	14,148	17,317
Realized losses on investment, net	1,388	4,798	—
Miscellaneous	2,364	9,788	505
Total noninterest expenses	79,186	63,185	49,252
Net income	$ 194,133	$ 130,606	$ 90,043

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