

CONTENTS

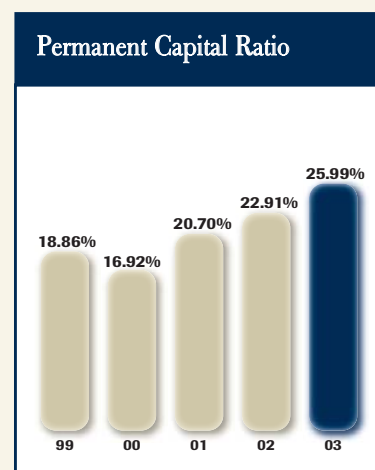
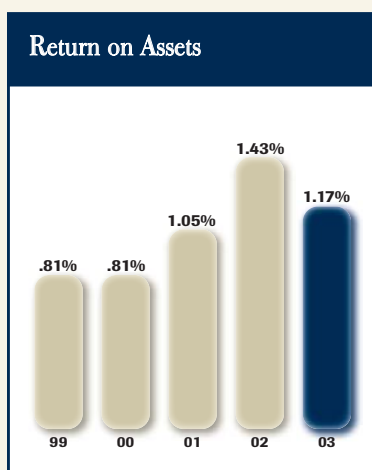
Five-Year Summary of Selected Consolidated Financial Data	2
Letter to Shareholders	4
Profile of AgFirst and Leadership	8
Expect the Best	
■ Retail Lending	10
■ Secondary Mortgage Market	12
■ Capital Markets Group	14
■ PeopleSoft®	16
■ AgScore	18
■ E-Commerce	20
■ Information Systems	22
2003 Financial Results	27

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

(unaudited)

(dollars in thousands)	2003	2002	December 31, 2001	2000	1999
Consolidated Balance Sheet Data					
Cash and cash equivalents	\$ 469,945	\$ 359,819	\$ 265,254	\$ 241,588	\$ 342,874
Investment securities	2,832,716	2,153,118	1,663,323	2,000,086	2,101,764
Loans	12,375,351	12,008,041	11,128,810	9,496,503	8,572,817
Less: allowance for loan losses	34,168	31,155	25,616	21,416	19,466
Net loans	12,341,183	11,976,886	11,103,194	9,475,087	8,553,351
Other assets	235,704	211,367	201,634	197,338	193,144
Total assets	<u>\$15,879,548</u>	<u>\$14,701,190</u>	<u>\$13,233,405</u>	<u>\$11,914,099</u>	<u>\$11,191,133</u>
Obligations with maturities of one year or less	\$ 6,384,790	\$ 6,273,546	\$ 7,976,947	\$ 6,556,988	\$ 6,126,495
Obligations with maturities greater than one year	8,315,226	7,444,960	4,302,671	4,669,337	4,416,259
Mandatorily redeemable preferred stock	225,000	—	—	—	—
Total liabilities	<u>14,925,016</u>	<u>13,718,506</u>	<u>12,279,618</u>	<u>11,226,325</u>	<u>10,542,754</u>
Mandatorily redeemable preferred stock	—	225,839	225,839	—	—
Perpetual preferred stock	150,000	—	—	—	—
Capital stock and participation certificates	229,083	249,444	281,803	301,189	300,088
Retained earnings	601,699	527,673	439,104	388,035	359,325
Accumulated other comprehensive income (loss)	(26,250)	(20,272)	7,041	(1,450)	(11,034)
Total shareholders' equity	<u>954,532</u>	<u>756,845</u>	<u>727,948</u>	<u>687,774</u>	<u>648,379</u>
Total liabilities and equity	<u>\$15,879,548</u>	<u>\$14,701,190</u>	<u>\$13,233,405</u>	<u>\$11,914,099</u>	<u>\$11,191,133</u>

HIGHLIGHTS



<i>(dollars in thousands)</i>	2003	2002	December 31, 2001	2000	1999
Consolidated Statement of Income Data					
Net interest income	\$ 244,057	\$ 255,660	\$ 184,782	\$ 135,164	\$ 145,814
Provision for loan losses	2,500	8,000	4,500	2,500	7,050
Noninterest income (expense), net	(64,108)	(53,527)	(49,676)	(42,621)	(52,200)
Net income	\$ 177,449	\$ 194,133	\$ 130,606	\$ 90,043	\$ 86,564

Consolidated Key Financial Ratios

Rate of return on average:

Total assets	1.17%	1.43%	1.05%	0.81%	0.81%
Total shareholders' equity	20.37%	23.75%	17.40%	12.72%	12.76%
Net interest income as a percentage of average earning assets	1.62%	1.91%	1.50%	1.23%	1.38%
Net chargeoffs (recoveries) to average loans	(0.004)%	0.02%	0.003%	0.01%	—
Total shareholders' equity to total assets	6.01%	5.15%	5.50%	5.77%	5.79%
Debt to shareholders' equity (:1)	15.64	18.13	16.87	16.32	16.26
Allowance for loan losses to loans	0.28%	0.26%	0.23%	0.23%	0.23%
Permanent capital ratio	25.99%	22.91%	20.70%	16.92%	18.86%
Total surplus ratio	25.79%	22.69%	19.86%	15.50%	16.72%
Core surplus ratio	14.45%	13.20%	10.39%	10.42%	10.89%
Collateral ratio	106.94%	105.94%	106.38%	104.95%	104.93%

Net Income Distribution

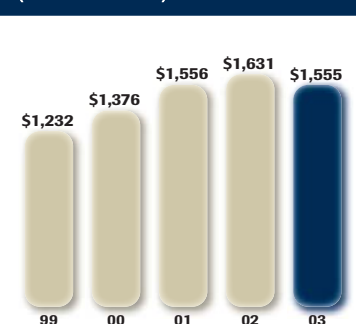
Cash distributions	\$ 92,129	\$ 86,677	\$ 67,786	\$ 61,333	\$ 59,697
--------------------	-----------	-----------	-----------	-----------	-----------

Mandatorily Redeemable Preferred Stock Dividend

	10,282	18,887	10,912	—	—
--	--------	--------	--------	---	---

Perpetual Preferred Stock Dividend

	1,851	—	—	—	—
--	-------	---	---	---	---

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

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

Trends
 (dollars in millions)




Board Chairman Paul Lemoine and CEO and President, Andy Lowrey

t o o u r s h a r e h o l d e r s

In 2003, AgFirst delivered the value that makes us an exceptionally successful cooperative. We provided superior loan products and support for our association-owners through ever-improving technological solutions and a dedicated and talented staff. And, most importantly, we produced stellar financial results with outstanding returns to our shareholders.

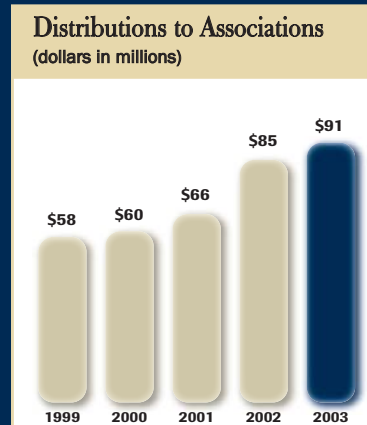
2003 Financial Performance

This past year presented challenges as we adapted to historically low rates, as well as a directional shift in rates. However, by any measure, it was a very successful year. We were coming off a phenomenally successful year in 2002, where funding strategies yielded unusually large spreads in an environment of rapidly and continuously dropping interest rates. In 2003, our inordinately large spreads began moving back toward a more normal range. Still, we finished 2003 with very healthy earnings of \$177.4 million, resulting in a return on equity of 20.37 percent and \$111 million paid to our shareholder associations, including \$91 million in cash distributions and \$20 million in stock redemptions.

Growth continued, albeit at a somewhat slower pace, with a \$1.2 billion, or 8.0 percent, increase in assets. This reflected the continued robust demand for agricultural credit, successful marketing campaigns of our affiliated associations, and an increase in our investment portfolio.

Considering where we were in the credit cycle in 2003, I am very proud of the asset quality we maintained. The general economic slowdown of 2001 and early part of 2002 had very little impact on our portfolio, and overall asset quality remains strong.

AgFirst shared more than 50 percent of its 2003 earnings with its affiliated ACAs.



Strategic Initiatives

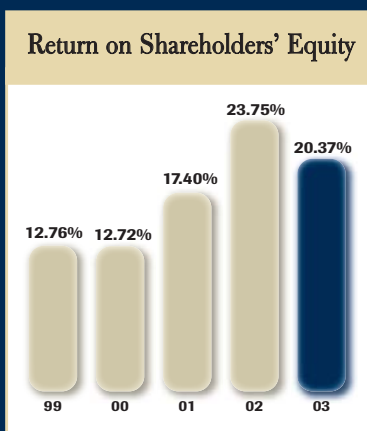
Strategic planning focuses the talent of our organization in those areas that enhance the well-being of our shareholders. Some of the key initiatives include:

- Positioning our capital levels to accommodate continued growth
- Expanding growth through capital markets activities
- Enhancing systems to improve efficiencies
- Enhancing disclosure and governance practices to reflect best practices

AgFirst is focused on the long-term value equation provided our shareholders. Consequently, we took advantage of favorable market conditions to build capital to support future growth. In October, we issued \$150 million in perpetual, non-cumulative preferred stock, which was readily received in the marketplace. With retained earnings from 2003, our capital improved by \$198 million, positioning us to acquire good assets as opportunities present themselves.

We expanded our universe of relationships both within and outside the Farm Credit System as we sought new opportunities to acquire assets, as well as sell various services, taking advantage of our core competencies where we have excess capacity. Our reputation as a reliable partner with expertise in the agricultural sector has created new opportunities for growth.

Over the past five years, we vastly improved our systems and technological expertise. However, much of the past effort was simply needed to catch up with the rest of the marketplace. Now, we are stepping out to differentiate ourselves with reliable systems that provide improved efficiencies for AgFirst and its customers.



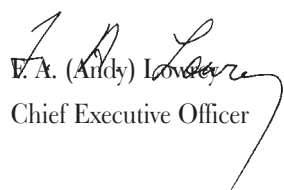
We finished 2003 with a very healthy return on equity of 20.37 percent.

During 2003, PricewaterhouseCoopers completed a Statement on Auditing Standards (SAS) 70 Type II examination of controls around two of our high-profile applications, Credit Delivery and Lawson Payroll. Following that initiative, we began a SysTrust Certification, an independent examination of the effectiveness of the controls over the availability and security of our information systems. Continuous enhancements to many applications were performed during the year as well as the implementation of a new general ledger system. You can see we have been very busy.

A full review of disclosure enhancements and governance best practices was completed in 2003, and efforts are underway to adopt those practices that mirror reporting of publicly traded companies, yet fit our cooperative structure. I am pleased to report that our bank had many of these best practices already in place, with strong internal controls, a disciplined disclosure regimen, an active audit committee and appropriate policies.

The AgFirst Story

Our story is a good one. It is one of sound growth, reliability of products and services, integrity, aggressive management of processes and outstanding returns. It is also a story about highly dedicated and talented people with a passion to serve rural America through our cooperative structure. A vibrant, healthy bank focused on long-term results is the best way to enhance the value proposition to our cooperative owners. Our owners expect the best from AgFirst, and that's what we deliver.


E. A. (Andy) Lowrey
Chief Executive Officer


Paul Lemoine
Chairman of the Board

*Growth continued with an
8 percent increase in assets.*



Who we are and what we do

AgFirst is a member of the Farm Credit System, the largest agricultural lending organization in the United States. We provide funding and services to 23 Agricultural Credit Associations (ACAs or associations) in 15 eastern states and Puerto Rico. The ACAs, in turn, provide financing to more than 80,000 farmers, ranchers, rural homeowners and agribusinesses. We also operate a Capital Markets Unit, which arranges and participates in loans for agribusinesses, and a Secondary Mortgage Market Unit, which buys, sells and services rural home and agricultural loans throughout the United States.

How we are organized and funded

AgFirst is owned by its affiliated ACAs. The ACAs benefit from their ownership of AgFirst in two important ways. In the delivery of funding and services to all 23 ACAs, AgFirst achieves economies of scale that could not be achieved by the associations individually. In addition, AgFirst shares its profits with the associations through patronage refunds. The patronage refunds we pay our associations reduce their cost of borrowing and, ultimately, their borrowers' cost of borrowing.

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

What we deliver

Through their affiliation with AgFirst, the ACAs have access to a broad range of financial tools that allows them to compete in today's global economy. These tools include:

- Lines of credit that enable borrowers to take advances at their choice of Prime, LIBOR or fixed rate.
- Credit Delivery, a loan origination system developed by AgFirst and used by all 23 of our member-associations.
- AgriLine®, an automated system that enables borrowers to write their own loan advances by check.
- FastCash, a product that enables associations to send loan advances to their borrowers' checking accounts overnight through the Automated Clearing House system.
- AutoDraft, a service that automatically drafts borrowers' loan payments.
- AccountAccess, an online service that provides loan and payment information to borrowers via a secure Internet site, and LoanLine, a service that provides the same information by telephone.
- AutoBorrow, a cash management product for commercial borrowers developed by AgFirst in partnership with Bank of America.

These products and services have helped our associations grow and gain market share throughout their chartered territories.



William R. Clayton, Senior Vice President
F. A. (Andy) Lowrey, President and Chief Executive Officer
Thomas S. Welsh, Executive Vice President

e x p e c t l e a d e r s h i p

e x p e c t c o m m u n i c a t i o n



Al Conner, Curt Carlson, Darrel Riddle, Randy Musselwhite, Tom Stallworth, Steve McClam

“I wanted to position the association so that we would never have to turn down a borrower because of capital constraints. I asked my relationship manager to help me develop a new concept for freeing up capital for growth. He championed my idea and worked with people throughout the bank to bring it to fruition. The result was a standby agreement with AgFirst for short-term loans. Now, my association is better positioned for growth.”

JACK SHULER, CHIEF EXECUTIVE OFFICER
Pee Dee Farm Credit, Florence, South Carolina

Retail Lending

Ask any loan officer how to create a strong relationship with a borrower. Ask any borrower what makes for a great relationship with a lender. The answer will be the same: Communication.

We believe that constant, consistent communications is the foundation of our relationship with our affiliated associations. AgFirst’s relationship managers help build that foundation every day. As the first line of contact between the bank and associations, they share information, resolve issues and cross-pollinate ideas among associations.

AgFirst’s relationship managers represent a deep pool of experience in lending to a variety of industries, including citrus, sugar, timber, pork, poultry and more. Associations draw on their expertise to analyze and structure large credit facilities and develop new lending opportunities.

Communications is not just talking. It’s listening, too. Traveling the district and meeting face-to-face with association management staffs and boards every week, our relationship managers do a lot of listening. Every day, they help cement the bond that keeps the AgFirst family strong.

“2003 was a record-breaking year for secondary mortgage market activity. My small staff was overwhelmed with the number of loans that we were originating. It was a huge relief to our workload when AgFirst introduced its correspondent website. The site gave us a comprehensive tool to streamline our loan origination process and improve our efficiency. That let us turn our attention to serving our customer, which is always our main goal. Thanks, AgFirst, for helping us put our customers first!”

CHERIE HALL, COUNTRY MORTGAGES MANAGER
MidAtlantic Farm Credit, Frederick, Maryland

Secondary Mortgage Market

We believe that people who live and work in the country deserve the same rates and loan products those in urban areas enjoy. That's why we established our Secondary Mortgage Market (SMM) operation in 1995. From the start, our mission has been to provide Farm Credit associations and other originators an avenue for selling rural home and part-time farm loans.

AgFirst's network of 107 mortgage originators spans the nation from New York to California; it includes 52 Farm Credit associations and 55 other lenders. In 2003, they sold a record 4,700 loans to AgFirst, representing more than \$676 million. By year-end, AgFirst's SMM was servicing 11,344 rural home and part-time farm loans totaling more than \$1.5 billion.

The SMM brings many benefits to its originators: new market opportunities, a source of fee income and a mechanism to free up capital for future growth. In 2003, the SMM set out to offer even more to its sellers by developing a new website that helps them process loans quickly and efficiently. Through this secure, interactive website, sellers can:

- Register and lock loans three different ways: by entering their data directly on the website, uploading information from their loan origination software, or importing data from Fannie Mae's Desktop Underwriter software.
- Get an immediate lock confirmation. Lock confirmations that used to take up to 24 hours are now available in less than five minutes. And, the lock confirmation includes an all-in price for the loan.
- View reports of all of the loans in their pipeline and drill down to specific loans.
- Access daily rate sheets and read announcements about new programs, program changes, and important dates. Sellers can also reference an online version of the Secondary Market Correspondent Guide.

And that's not all. The SMM is already working on enhancements to the site to add functionality for funding requests, online purchase advices, loan document tracking, and more. Because our associations expect efficiency, that's what the SMM delivers.

e x p e c t e f f i c i e n c y



Tom Griffin, Donna Gantt, Carla White, Mark Shelby, Bryan Grainger

e x p e c t o p p o r t u n i t i e s



Michael Mancini, Bill Melton, Felicia Morant, John Burnside, Steve O'Shea, Bruce Fortner

“Some of the largest poultry and pork producers in the nation are headquartered within our territory. To meet their needs—to offer them competitive rates and terms—we need a lending partner with strong capital and strong skills. For years, AgFirst’s Capital Markets Group has proven they have the expertise to structure and place such deals.”

ROYCE EDWARDS, CHIEF OPERATING OFFICER
Cape Fear Farm Credit, Fayetteville, North Carolina

Capital Markets Group

AgFirst’s Capital Markets Group canvasses the United States looking for lending opportunities for the AgFirst family of associations. Through the group, AgFirst partners with commercial banks, insurance companies and other Farm Credit institutions in loan participations and syndications related to food, agriculture, agribusiness, and rural utilities. We participate both directly and as agent for our affiliates and service these loans for them. In 2003, we sold more than \$479 million in loans to our affiliates, helping increase their earnings, as well as grow and diversify their portfolios.

The Capital Markets Group also works closely with associations to develop large-loan opportunities within their territories. Acting as a participation partner or arranging agent, AgFirst buys loans from associations and sub-participates them throughout the nation. Last year, we managed the sale of more than \$153 million in participations to other lenders.

The services offered by the Capital Markets Group help associations manage their capital, lending limits, hold positions and credit risks. And, associations stand to share in the earnings of AgFirst’s participation loan pool. For the past three years, AgFirst has paid an average patronage refund of \$4.7 million annually to the pool’s participants, while adding a like amount to the bank’s retained earnings. AgFirst’s capital market activities enrich all associations’ borrowers, large or small.

Our associations expect opportunities from AgFirst, and that’s what the Capital Markets Group delivers.

“Our time-reporting systems were paper-based, cumbersome and time-consuming. Now that we’ve implemented AgFirst’s new general ledger and time-tracking systems, we’re able to create and store our work and leave records electronically, making for improved filing, data retrieval, and reporting. More importantly, we’re saving time (no more double entries!), and that means more money to our bottom line.”

GREG ELLIS, CHIEF FINANCIAL OFFICER
Farm Credit of Central Florida, ACA, Lakeland, Florida

PeopleSoft®

In 2002, AgFirst made the decision to purchase PeopleSoft’s Enterprise Financial Management software to replace its general ledger and related systems. Thus began one of the largest, most complex projects AgFirst has ever undertaken.

Before the first conversion program was written, the PeopleSoft Project Team performed a thorough “spring cleaning” of our processes and procedures. Questioning everything, they swept away the cobwebs, mapped our current methods and compared them to industry best practices. They talked to our customers and revealed unmet needs. In the end, they proposed better ways of doing almost everything.

With that roadmap, the project team, which included people from almost every department in the bank, began their work in early 2003. Working countless hours side-by-side, they produced a product we’re proud to offer our associations: a general ledger system with robust data analysis and reporting capabilities; new, more efficient systems for accounts payable, fixed assets, and expense reporting; and, a time-tracking module that is seamlessly coupled with our payroll system.

As we continue rolling out these new systems in 2004, more and more associations will realize the time and cost savings that Farm Credit of Central Florida has seen. They will realize, too, that the PeopleSoft Project Team has set a standard for achievement.

e x p e c t a c h i e v e m e n t



Theresa Justice, DeWitt Brown, Wanda Martin, Patti Trotter, Tom Sliker

e x p e c t s o l u t i o n s



Michael LeBron, Karon Heape, Allison Salley, Balachander Sivankoil, Dan Robinson, Dave Hogan

“AgFirst hit a home run with AgScore. It’s helping us make consistent, informed loan decisions and reduce the time and paperwork involved in making a loan. Best of all, we’re giving our customers quick answers to their loan requests. They like that, and so do we.

DEENA SHEALY, UNDERWRITER
Southwest Georgia Farm Credit, ACA, Bainbridge, Georgia

AgScore

Farm Credit associations throughout the nation have long recognized the advantages of using credit scoring to streamline the process of making small, low-risk loans. Credit scoring helps them make fast, accurate decisions, and that makes for happier customers.

Until recently, most associations subscribed to Fair Isaac’s popular credit-scoring engine, Credit Desk®, to process those loans. When Fair Isaac announced that it would not support Credit Desk® for district associations after September 2004, AgFirst began work to fill that void. The result is a product we call AgScore, a web-based portal to Fair Isaac’s LiquidCredit® Small Business Scoring System.

Since we introduced AgScore in September 2003, we’ve received good feedback about its ease of use, flexibility, and high-speed performance. Associations throughout the district and the nation are enjoying the cost savings and efficiencies it has brought to their operations. They like the fact that their customers are getting quick decisions on their loans, sometimes leaving the office with a check within an hour.

Faster loan decisions? Happier customers? No problem. AgFirst will find a solution.

“Many of our borrowers do their bookwork in the evenings or on weekends. They need access to their loan information when our office is closed. With AccountAccess, they can get up-to-date information on their loans whenever they need it—24 hours a day, 7 days a week.”

BRUCE LEIMBACH, BRANCH MANAGER
AgCredit, Norwalk, Ohio

E - Commerce

Our associations' borrowers are busy, productive people. They need accurate information to make good decisions. And they need it when they need it—fast and always available.

That's why AgFirst developed AccountAccess, a way for association borrowers to view their loan information 24/7 in a secure, online environment. Since its introduction in 1998, AccountAccess has grown to include more and more information that borrowers and associations want and need: account history, AgriLine® check activity, payment information and more—all updated on a daily basis. And soon, borrowers will be able to initiate FastCash transactions and make loan payments online.

More than 60 percent of the borrowers in our district access the Internet, and the numbers are growing exponentially each year. Farmers and agribusinesses have always been quick to adopt new technologies that help them improve their productivity. That's why our associations expect innovation from AgFirst, and that's what we deliver.

e x p e c t i n n o v a t i o n



Gregg Steinmeyer, Tony Stone, Donna Camacho, Jack Kuppuswamy

e x p e c t r e l i a b i l i t y



Chad Toney, Robert Zeman, Jeff Cash, Kay Jay

“Software installations and updates used to require traveling to the branch offices. Now, many of these tasks are completed remotely with Altiris. I don’t even have to leave my desk! And, the Carbon Copy remote control feature means fewer trips to branch offices for help desk-type calls. Altiris has proven itself as a valuable tool that saves time and money for our association.”

BOB BRIDGES, SENIOR INFORMATION SYSTEMS SPECIALIST
Farm Credit of North Florida, Alachua, Florida

Information Systems

“Do your own thing” was the mantra of the baby boomer generation as they came of age in the 1960s and ‘70s. The baby boomers brought that attitude with them as they moved into the ‘80s and began using computers. And, why not? Technology is fun (ask any kid!), and it’s fun to try new things.

As technology has matured, so have its users. As we’ve matured, our approach to technology has changed. We now ask questions about “efficiency” and “total cost of ownership,” and that leads to more questions about “standardization” and “centralization.”

The AgFirst district has asked those questions, and the answers have led us to the very simple technology model we embrace today:

- To save time and money, let’s all use the same hardware and software.
- Instead of 23 associations doing their own thing, let’s let AgFirst—the bank we own—do as much as they can for us. And let’s hold them accountable.

At AgFirst, we still think technology is fun, but it’s also a business we take very seriously. We know that every association in the district relies upon us to keep their systems going. That’s why we have four watchwords that govern everything we do in technology: *Reliability. Availability. Security. Performance.*

Reliability means that our systems are up and available to every employee in the district during each business day. It means files are updated accurately and on time every night, and borrowers have online access to their account information 24/7. From server clustering to disk arrays, we’ve employed a number of measures to ensure reliability of our hardware, software and systems.

Availability means access, anytime, anywhere. Our frame relay network and Citrix-based environment give users secure access to business-critical applications from any location, on any device, and over any connection.

Security means passwords and anti-virus detection to most users, but to AgFirst it means much more. Our security controls address three important areas: physical, environmental and communications systems.

Performance is something we all take for granted—until systems don't work as expected. At AgFirst, we do a lot of work behind the scenes to ensure our systems perform correctly. Not only do we test our own controls, we ask outside experts to test them, as well. In 2003, PricewaterhouseCoopers completed a SAS 70 Type II Report, testing control objectives around two of our premier applications, Credit Delivery and Lawson Payroll. Following that, we began a SysTrust Certification initiative, an independent validation of our information technology controls.

Beyond reliable, high-quality systems, the associations we serve expect technology that helps them reduce costs and improve efficiencies. AgFirst has made significant investments in Credit Delivery and other systems that do just that. One proof of the efficacy of our efforts is the fact that, since 1997, loan volume serviced per employee has increased 58 percent district-wide. To look at that another way, without the efficiencies we have achieved, our district would need 1,100 more employees than we have today to service our current portfolio.

Efficiency. Reliability. Availability. Security. Performance. It's what our customers expect from AgFirst. And it's what we deliver.

e x p e c t p e r f o r m a n c e

25



Ron Hollins, Wayne Arant, Brian Kelley

2003 FINANCIAL RESULTS

Report of Management	28
Management's Discussion and Analysis	29
Additional Disclosures	41
Report of Independent Auditors	45
Consolidated Balance Sheets	46
Consolidated Statements of Income	47
Consolidated Statements of Changes in Shareholders' Equity	48
Consolidated Statements of Cash Flows	49
Notes to the Consolidated Financial Statements	50
Management and Board of Directors	65

REPORT OF MANAGEMENT

28

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

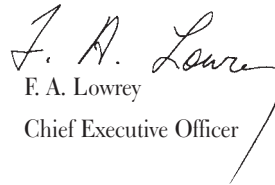
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all consolidated financial statements, and that the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

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

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Bank. The undersigned certify that the 2003 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.



Paul Lemoine
Chairman of the Board



F. A. Lowrey
Chief Executive Officer



Leon T. Amerson
Chief Financial Officer

February 24, 2004

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

(dollars in thousands, except as noted)

The following commentary reviews the financial condition and results of operations of AgFirst Farm Credit Bank (the Bank or AgFirst) for the years ended December 31, 2003, 2002 and 2001. This information should be read in conjunction with the accompanying consolidated financial statements, the notes to the consolidated financial statements and other sections of this annual report. See Note 1, *Organization and Operations*, in the notes to the consolidated financial statements for a discussion of the operations of AgFirst.

Financial Overview

The following information provides an overview, in capsule form, of AgFirst's financial results for 2003 as compared to 2002 and 2001:

- The aggregate principal amount of loans outstanding at December 31, 2003 was \$12.4 billion compared to \$12.0 billion at December 31, 2002, and \$11.1 billion at December 31, 2001, reflecting increases of 3.33 percent and 11.71 percent compared to 2002 and 2001, respectively.
- Net income totaled \$177.4 million for the twelve months ended December 31, 2003, reflecting an 8.60 percent decrease and a 35.87 percent increase compared to the years ended December 31, 2002 and 2001, respectively.
- AgFirst's ratio of total shareholders' equity to total assets increased from 5.15 percent at December 31, 2002 and 5.50 percent at December 31, 2001 to 6.01 percent at December 31, 2003 — primarily attributable to the issuance of \$150 million of noncumulative perpetual preferred stock.
- AgFirst's return on average total assets and return on average shareholders' equity for the year ended December 31, 2003 were 1.17 percent and 20.37 percent, respectively, compared to 1.43 percent and 23.75 percent for the year ended December 31, 2002, and 1.05 percent and 17.40 percent for the year ended December 31, 2001.

Loans

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

(dollars in thousands)

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

(dollars in thousands)

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

(dollars in thousands)

	2001	
	\$	%
Direct Notes	\$ 8,913,269	80.09%
Participations purchased, net	1,556,413	13.99
Secondary Mortgage	661,648	5.95
SFAS No. 133 Adjustment	(3,199)	(.03)
Other	679	—
Total	\$ 11,128,810	100.00%

The table illustrates that the loan growth came primarily through the direct notes. Since this activity is used to support Association lending, the growth is a direct result of increased Association loan portfolios. The Associations' growth is consistent with trends in other Farm Credit System institutions and is attributed to a robust agricultural economy, with income bolstered by 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.

Direct Notes

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

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

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS (continued)

30

creditworthiness of both the Associations that are direct borrowers and the underlying borrowers of the Associations as indirect borrowers of AgFirst.

AgFirst continually monitors the risk-bearing capacity of each Association through a variety of mechanisms, including testing of the reliability of the Association's credit classifications, periodic meetings with Association Management and Boards, semi-annual formalized risk assessments, and prior-approval of transactions that exceed the Association's delegated authority (which is determined by AgFirst). In addition, Associations are subject to an annual audit by independent auditors and periodic examination by the FCA.

All Associations exceeded the minimum GFA and regulatory requirements for liquidity, earnings, and capital as of December 31, 2003. It is anticipated that all Associations will receive unqualified audits from their external auditors. No Association is operating under a supervisory action and the litigation in which Associations are involved is typically loan related and poses no material threat to their viability.

Associations employ a number of risk management techniques to limit credit exposures. Each Association has adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios and the Associations utilize guarantees from other agencies, including Farmer Mac, the Farm Services Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2003, Associations collectively had \$1.1 billion under various government or Government Sponsored Enterprise (GSE) guarantee programs.

Each Association maintains 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	25.83%	25.24%	3.50%
Mean	15.12%	11.47%	2.28%
Low	11.78%	8.23%	1.54%

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

State	2003	2002	2001
North Carolina	16%	17%	17%
Florida	16	14	14
Georgia	12	12	13
Virginia	11	11	11
Pennsylvania	11	11	9
South Carolina	7	7	9
Maryland	7	6	6
Ohio	5	5	5
Alabama	3	3	3
Kentucky	3	3	2
Mississippi	2	2	2
Delaware	2	2	2
Puerto Rico	1	2	2
West Virginia	2	2	2
Louisiana	1	2	2
Tennessee	1	1	1
Total	100%	100%	100%

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

Credit quality within the combined Associations' portfolios improved slightly during the twelve months ended December 31, 2003. At year-end, the combined Associations' net loans were classified as follows:

	2003	2002	2001
Acceptable	92.72%	92.54%	92.05%
OAEM	4.96	4.95	5.38
Adverse	2.32	2.51	2.57
Total	100.00%	100.00%	100.00%

Acceptable loans are all those that are not criticized. Criticized loans are all those that are classified as OAEM, substandard, doubtful or loss loans. Other Assets Especially Mentioned (OAEM) loans assets are considered fully collectible but have potential weaknesses. Adverse loans include substandard, doubtful, and loss loans.

Delinquencies were .73 percent of total loan assets at year-end 2003 compared to .81 percent and .74 percent at year-end 2002 and 2001, respectively. Nonperforming assets for the combined ACAs represented .73 percent of total loan assets or \$92 million for 2003, .80 percent or \$95 million for 2002 and .81 percent or \$86 million for 2001. Nonperforming assets are loans which consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

Net chargeoffs of \$3.1 million, \$13.2 million and \$3.2 million were recorded in 2003, 2002, and 2001, respectively. As a percentage of total loan assets, net chargeoffs for the combined Associations were .02 percent for 2003 compared to .11 percent and .03 percent in 2002 and 2001, respectively.

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

Earnings for the combined Associations totaled \$231.6 million, \$202.4 million, and \$240.9 million, producing an average return on assets of 1.85 percent, 1.77 percent, and 2.33 percent, and an average return on equity of 12.26 percent, 10.67 percent, and 13.04 percent for 2003, 2002, and 2001, respectively. The increase in combined earnings in 2003 as compared to 2002 is the result of \$737 million growth in loans and an average spread increase of 10 basis points. The decrease in combined earnings as compared to 2001 is due, in large part, to income from tax refunds in 2001 versus net tax expense in 2003.

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

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

Commodity Group	Percent of Portfolio		
	2003	2002	2001
Poultry	13%	13%	15%
Forestry	12	11	9
Grain	10	9	10
Cattle	9	8	9
Dairy	8	7	7
Fruits/Vegetables	5	5	6
Nursery/Greenhouse	5	5	5
Processing	4	5	2
Rural Home	4	4	6
Swine	3	4	4
Tobacco	4	4	6
Citrus	3	4	3
Cotton	3	4	5
Other	17	17	13
Total	100%	100%	100%

The table illustrates that 2003 commodity concentrations were 5 percent or more in only seven segments. The concentration in these segments is mitigated by a prevalence of non-farm income among the borrowers as demonstrated by the following table, which segregates part-time farm loans into a unique segment.

Commodity Group	Percent of Portfolio		
	2003	2002	2001
Part-time Farmers	46%	45%	44%
Poultry	11	11	12
Dairy	8	7	7
Grain	3	5	6
Forestry	4	4	4
Cattle	3	3	3
Cotton	3	3	3
Nursery/Greenhouse	4	3	3
Swine	3	3	4
Tobacco	3	3	3
Other	12	13	11
Total	100%	100%	100%

The two commodities in which the combined Associations have a concentration of full-time farmers greater than 5 percent are poultry and dairy. The poultry concentration is composed primarily of chicken, turkey, and egg production. The Associations finance contract grower loans and originate many poultry integrator loans. Due to Association commodity and/or borrower exposure limits, these loans are syndicated or participated to AgFirst and/or commercial banks. The financial statements of the integrators are reviewed by the Bank and applicable Associations regularly and currently reflect the capacity to honor the grower contracts. Production is spread throughout the combined Associations' footprint and credit risk is mitigated somewhat by guarantees. Dairy volume is also spread throughout the combined Associations' footprint. Herd sizes range from less than 100 cows to over 10,000. Associations also manage their credit and concentration risk through participations and with guarantees.

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS (continued)

32

Individual loan exposures totaling \$5 million or greater, which represent the commercial and corporate side of agribusiness, comprise approximately 15 percent of Association loan volume. As mentioned above, loans exceeding an Association's delegated lending authority must be pre-approved by AgFirst. As a result, larger agribusiness loans are typically analyzed by AgFirst's commercial lending staff as well as the Associations' own lending staff prior to an Association committing to such loans. Much of the individual loan exposure above \$5 million is subsequently sold to other Associations or AgFirst.

Approximately 50 percent of outstanding loan volume is comprised of loans under \$500 thousand, and loans less than \$100 thousand make up 15 percent of loan volume. This diversification among borrowers is another key component of the Associations' stable credit quality and solid financial performance over time.

Participations/Syndications

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

The AgFirst Participation/Syndication portfolio average outstanding volume for the twelve months ended December 31, 2003 totaled \$1.39 billion, which reflects a decrease of \$76 million or 5 percent, compared to 2002. The following table shows credit exposures as of December 31.

	2003	2002	2001
Participations Purchased	\$ 1,898,309	\$ 1,953,302	\$ 1,922,886
Less: Participations Sold	343,547	321,991	366,473
Net Outstanding	1,554,762	1,631,311	1,556,413
Available Commitment	855,727	891,048	729,418
Letters of Credit and Guarantees	239,211	212,588	178,059
Total Exposure	\$ 2,649,700	\$ 2,734,947	\$ 2,463,890

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

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

	2003		2002		2001	
	\$	%	\$	%	\$	%
Florida	\$ 278,446	18%	\$ 284,173	17%	\$ 268,900	17%
North Carolina	192,324	12	246,682	15	193,297	12
Virginia	75,480	5	102,229	6	93,738	6
Texas	76,494	5	98,936	6	66,790	4
South Carolina	129,686	8	98,385	6	78,967	5
Missouri	78,580	5	83,479	5	76,010	5
Pennsylvania	80,997	5	82,564	5	78,104	5
California	35,677	2	81,791	5	65,203	4
Georgia	79,333	5	78,568	5	143,918	9
Minnesota	94,138	6	66,492	4	73,948	5
Illinois	24,515	2	62,075	4	28,279	2
New York	85,467	6	54,063	3	61,154	4
Ohio	30,603	2	44,920	3	59,814	4
Hawaii	25,068	2	12,741	1	-	-
Oklahoma	16,949	1	33,977	2	21,527	1
Other	251,005	16	200,206	13	246,764	17
Total	\$1,554,762	100%	\$1,631,311	100%	\$1,556,413	100%

Commodity Group	Percent of Portfolio		
	2003	2002	2001
Meat Products	17%	14%	14%
Electric Utilities	11	13	14
Agribusiness	14	12	12
Telephone Utilities	7	9	10
Sugar Cane/Sugar Beets	9	8	10
Citrus	6	7	6
Swine	6	7	6
Poultry & Eggs	5	6	3
Horticulture	3	5	4
Forestry	5	4	7
Sawmill/Planing Mills	4	4	3
Other	13	11	11
Total	100%	100%	100%

Credit quality at year-end 2003 reflected improvement. At December 31, 2003, fully acceptable volume was 92.94 percent compared to 91.74 percent and 94.51 percent for 2002 and 2001, respectively. The OAEM category was 3.66 percent, 4.94 percent, and 3.08 percent for years ended 2003, 2002, and 2001, respectively. Substandard volume decreased from 3.33 percent in 2002 to 2.78 percent in 2003, but increased slightly from 2.40 percent in 2001. Doubtful volume at year-end 2003 was one loan representing .62 percent of total outstanding volume. This account was in the process of being restructured at year-end.

Secondary Mortgage Market Loans

AgFirst operates a Secondary Mortgage Market Unit (SMMU) to facilitate the purchase and sale of loans in the secondary market. Loans purchased by the SMMU to be "held to maturity" are

generally guaranteed by Fannie Mae and/or Farmer Mac, thereby exposing AgFirst to little credit risk. Technically, the guarantees are in the form of *Long-Term Standby Commitments to Purchase*, which give AgFirst the right to deliver delinquent loans to the “guarantor” at par.

The table below illustrates the SMMU gross unpaid principal of loans outstanding at December 31, 2003, 2002 and 2001.

<i>(dollars in millions)</i>	2003		2002		2001	
Rural Home Loans -						
Guaranteed	\$ 18.2	8%	\$166.5	48%	\$527.1	79%
Part-time Farm Loans -						
Guaranteed	110.6	48	83.0	24	34.3	5
Agricultural Loans -						
Guaranteed	4.4	2	3.2	1	4.0	1
Non-guaranteed Loans	95.1	42	92.4	27	100.5	15
Total	\$228.3	100%	\$345.1	100%	\$665.9	100%

Rural home loans are loans that conform to Fannie Mae underwriting standards and are guaranteed by Fannie Mae and Farmer Mac. These loans, which are readily marketable, are held by AgFirst as “available for sale.” During 2003, AgFirst purchased \$667 million of such loans, but sold \$754 million, resulting in the net outstanding balance of \$18 million. Net gains on the sale of these loans totaled \$1,859 thousand in 2003.

Part-time farm loans represent first lien mortgages on homes with property characteristics (such as acreage or agricultural improvements) that do not conform to Fannie Mae standards. These loans are guaranteed by Farmer Mac and are accounted for as “held-to-maturity.”

AgFirst owns \$4 million of *agricultural loans* that are guaranteed by Farmer Mac. This segment is small, due primarily to the Associations’ propensity to hold agricultural loans (their core business) in-portfolio. Through AgFirst, a number of Associations obtain Farmer Mac guarantees for qualifying segments of their agricultural portfolios, thereby eliminating the need to sell those loans to the Bank.

The \$95 million of *non-guaranteed loans* generally consists of loans that are being held for eventual delivery to, or guarantee by, Fannie Mae or Farmer Mac. All such loans are secured by first-lien mortgages and are considered very high quality assets.

AgFirst services the loans that it purchases, and typically retains servicing on loans sold. The total volume being serviced as of December 31, 2003 was \$1.5 billion, with the servicing asset valued at \$10.5 million.

Purchases of rural home and part-time farm loans began the year at a robust rate, with monthly purchases averaging \$61.2 million during the first six months of 2003. The significant volume of purchases is attributed to the historically low interest rate environment, which borrowers took advantage of to re-finance or “trade up.” As a relatively new participant in the secondary housing loan market, AgFirst was a net beneficiary of the home financing

boom. A sharp increase in mortgage rates at mid-year resulted in a decline in mortgage activity toward year-end. The slowdown in mortgage activity in general, coupled with the normal seasonal decrease, resulted in purchases totaling only \$29 million during the month of December.

Results of Operations

Net Income

AgFirst net income totaled \$177,449 for the year ended December 31, 2003, a decrease of \$16,684 from 2002, while 2002 net income increased \$63,527 from 2001. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

<i>(dollars in thousands)</i>	Year Ended December 31,	
	2003	2002
Net income (for prior year)	\$194,133	\$130,606
Increase (decrease) due to:		
Total interest income	(78,862)	(133,226)
Total interest expense	67,259	204,104
Net interest income	(11,603)	70,878
Provision for loan losses	5,500	(3,500)
Noninterest income	(14,758)	15,560
Noninterest expense	4,177	(19,411)
Total increase (decrease) in net income	(16,684)	63,527
Net income	\$177,449	\$194,133

Interest Income

Total interest income for the year ended December 31, 2003 was \$528,549, a decrease of \$78,862 as compared to the same period of 2002. Total interest income for 2002 was \$607,411, a decrease of \$133,226 as compared to the same period of 2001. The year-to-year decreases are primarily attributed to the decreasing rate environment seen during that period; 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.

<i>(dollars in thousands)</i>	Year Ended December 31,	
	2003-2002	2002-2001
Increase in average earning assets	\$1,613,328	\$ 1,116,520
Average yield (prior year)	4.52%	6.02%
Interest income variance attributed to change in volume	72,989	67,179
Average earning assets (current year)	15,039,283	13,425,956
Increase (decrease) in average yield	(1.01%)	(1.49%)
Interest income variance attributed to change in yield	(151,851)	(200,405)
Net change in interest income	\$ (78,862)	\$ (133,226)

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS (continued)

34

Interest Expense

Total interest expense for the year ended December 31, 2003 was \$284,492, a decrease of \$67,259 as compared to the same period of 2002. Total interest expense for the year ended December 31, 2002 was \$351,751, a decrease of \$204,104 as compared to the same period of 2001. The decrease in interest expense is primarily attributed to falling interest rates, offset somewhat by an increase in interest-bearing liabilities to support asset growth.

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

With the adoption of SFAS No. 150 on July 1, 2003, dividends on mandatorily redeemable preferred stock are required to be

reflected prospectively as interest expense. As a result, \$9,443, which represents dividends from July 1, 2003 to December 31, 2003 on the \$225,000 mandatorily redeemable preferred stock, was reflected as interest expense rather than an adjustment to capital in 2003.

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

(dollars in thousands)	Year Ended December 31,	
	2003-2002	2002-2001
Increase in average interest-bearing liabilities	\$ 1,785,172	\$ 1,004,400
Average rate (prior year)	2.82%	4.85%
Interest expense variance attributed to change in average interest-bearing liabilities	50,390	48,729
Average interest-bearing liabilities (current year)	14,246,736	12,461,564
Increase (decrease) in average rate	(.83%)	(2.03%)
Interest expense variance attributed to change in rate	(117,649)	(252,833)
Net change in interest expense	\$ (67,259)	\$ (204,104)

Net Interest Income

Net interest income increased from 2001 to 2002, but declined from 2002 to 2003, as illustrated by the following table:

Analysis of Net Interest Income

(dollars in thousands)	2003		2002		2001	
	Avg. Balance	Interest	Avg. Balance	Interest	Avg. Balance	Interest
Loans	\$12,058,243	\$ 469,148	\$11,489,521	\$ 544,575	\$10,186,358	\$ 636,118
Cash & Investments	2,981,040	59,401	1,936,435	62,836	2,123,077	104,519
Total Earning Assets	\$15,039,283	\$ 528,549	\$13,425,956	\$ 607,411	\$12,309,435	\$ 740,637
Interest-Bearing Liabilities	\$14,246,736	\$(284,492)	\$12,461,564	\$(351,751)	\$11,457,163	\$(555,855)
Impact of Capital	\$ 792,547		\$ 964,392		\$ 852,272	
NET INTEREST INCOME		\$ 244,057		\$ 255,660		\$ 184,782
	Average Yield		Average Yield		Average Yield	
Yield on Loans	3.89%		4.74%		6.24%	
Yield on Cash & Investments	1.99%		3.24%		4.92%	
Yield on Earning Assets	3.51%		4.52%		6.02%	
Cost of Interest-Bearing Liabilities	2.00%		2.82%		4.85%	
Spread	1.51%		1.70%		1.17%	
Impact of Capital	.11%		.20%		.33%	
Net Interest Income/Avg. Earning Assets	1.62%		1.90%		1.50%	

Net interest income for 2003 was \$11,603 less than 2002. The decrease was primarily due to a 1.01 percent decrease in average spread, the mandatorily redeemable preferred stock dividend being reflected as interest expense during the second half at 2003, and lower earnings on assets funded with capital (due to lower rates), partially offset by the effect of a \$1.6 billion increase in average earning assets, and the impact of preferred stock.

The Bank's average spread declined by 19 basis points compared to 2002. Net interest income (and spread) in 2002 was positively impacted by AgFirst's ability to exercise call options on debt during the decline in interest rates, effectively lowering its cost of funds relative to the assets, which did not prepay as quickly. The spread was expected to return to more normal levels through time, as asset prepayments "catch up" to called debt levels or as the assets and underlying funding mature or reprice in the normal course of business. The decline in spread reflects the anticipated "return toward normalcy."

Net interest income in 2002 was \$70,878 greater than 2001. The increase was primarily due to a \$1.116 billion increase in average earning assets, the improvement in spread discussed above, and the issuance of preferred stock, which effectively replaced interest-bearing debt securities with dividend-paying equities.

Provision for Loan Losses

The Bank assesses risks inherent in its portfolio on an ongoing basis and establishes an appropriate reserve for loan losses. The provision for loan losses totaled \$2,500 in 2003 compared to \$8,000 and \$4,500 in 2002 and 2001, respectively. See Note 4, *Loans and Allowance for Loan Losses* in the notes to the consolidated financial statements for further information.

Analysis indicates that an allowance for losses for AgFirst's direct note portfolio is not warranted. Allowance for losses as a percent of participations/syndications and SMMU outstanding was 1.92 percent, 1.58 percent and 1.15 percent in 2003, 2002 and 2001, respectively.

In June 2003, the American Institute of Certified Public Accountants' Accounting Standards Executive Committee (AcSEC) issued a proposed Statement of Position (SOP) – Allowance for Credit Losses, which was intended to clarify the methodology for estimating the allowance for credit losses and to enhance financial statement disclosures related to the allowance for credit losses. In January 2004, AcSEC dropped its proposed SOP and announced that it would focus instead on improving financial statement disclosures in this area.

System institutions plan to conduct studies to further refine their methodologies, including what are currently acceptable and permissible under generally accepted accounting principles, focusing specifically on the Securities and Exchange Commission and Federal Financial Institutions Examination Council

guidelines. Such a study would likely be completed by the fourth quarter of 2004 with any appropriate changes to the allowance for loan losses implemented at that time.

Noninterest Income

Noninterest income for the year ended December 31, 2003 was \$9,513, a decrease of \$14,758 compared to 2002. Noninterest income for the year ended December 31, 2002 was \$24,271, an increase of \$15,560 compared to 2001. The decrease from 2002 was primarily due to a decrease in secondary mortgage operations income and partially offset by an increase in realized gains on investments. During 2003 AgFirst recorded a \$1,445 loss in secondary mortgage operations compared to \$15,796 secondary mortgage operations income in 2002. Likewise, the increase from 2001 to 2002 was primarily due to the 2002 secondary mortgage operations income, which was a result of gains on sale of rural home loans.

The Secondary Mortgage Market Unit (SMMU) operations income (loss) consists of the following:

	Year Ended December 31,		
	2003	2002	2001
Servicing income	\$ 3,014	\$ 1,495	\$ 717
Gain (loss) on sale of loans	(1,859)	14,301	—
Impairment of servicing assets	(2,600)	—	—
Total SMMU income (loss)	<u>\$ (1,445)</u>	<u>\$ 15,796</u>	<u>\$ 717</u>

In addition, there was an increase in realized gains on investments of \$1,635 for 2003 compared to 2002. 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.

Noninterest Expense

Noninterest expense for the year ended December 31, 2003 was \$73,621, a decrease of \$4,177 as compared to the same period of 2002, and an increase of \$15,234 compared to 2001.

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS (continued)

The following table illustrates the sources of variance.

(dollars in thousands)	Year Ended December 31,	
	2003	2002
Prior Year Noninterest Expense	\$77,798	\$58,387
Change in Expense:		
Salaries and employee benefits	860	4,992
Occupancy and equipment	586	819
Intra-System financial assistance expense	(2,150)	1,310
Insurance fund premium	1,382	632
Other operating expenses	(2,897)	6,194
Called debt expense	(1,782)	3,903
Miscellaneous	(176)	1,561
Noninterest Expense	\$73,621	\$77,798

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. Weak investment performance and lower discount rates resulted in substantially higher pension expense. Lower discount rates and increasing healthcare trends had a similar impact on post-retirement healthcare expense. AgFirst, along with other participating Associations, adopted changes to their respective benefits plans effective January 1, 2003, in an effort to moderate future increases. Salary and purchased services expenditures related to the development and implementation of software are capitalized during development, and then expensed over the useful life of the software through depreciation. Such salary capitalization partially offset the impact of the aforementioned salary and benefits trend.

Occupancy and equipment expenses increased during 2002 and 2003, as a result of a technology renovation aimed at improving AgFirst's technical infrastructure and updating various systems.

Intra-System financial assistance 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. Financial assistance expense declined from 2002 to 2003 due to the retirement of several Financial Assistance Corporation bonds. See Note 11, *Intra-System Financial Assistance*, in the notes to the consolidated financial statements for further information.

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 in 2001 to .03 percent of retail loans outstanding in 2002. As a result, expense increased to \$632 in 2002. In 2003 the premium increased from .03 percent to .12 percent of retail loans and resulted in an expense of \$2,014.

Other operating expenses increased significantly from 2001 to 2002, then decreased from 2002 to 2003. The decrease from 2002 to 2003 was primarily the result of the capitalization of purchased service expenses related to implementation of new financial systems. The increase from 2001 to 2002 was primarily the result of purchased service expenses related to a thorough review and revamping of its accounting processes in preparation of implementing new financial systems in the 2003 – 2004 timeframe.

Unamortized concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. Falling interest rates enabled AgFirst to call a substantial amount of debt during 2003 and 2002, resulting in called debt expense of \$11,736 and \$13,518, respectively.

Liquidity and Funding Sources

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

Investments, Cash and Cash Equivalents

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

Investment securities and cash equivalents outstanding as of December 31, 2003 for AgFirst totaled \$3.30 billion compared to \$2.50 billion and \$1.92 billion at December 31, 2002 and 2001, 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, 2003.

(dollars in thousands)

<i>(dollars in thousands)</i>	2003		2002		2001	
Investment Securities						
Commercial Paper	\$ 229,879	7%	\$ 259,820	10%	\$ 280,576	15%
U.S. Govt. GNMA MBS/CMOs	911,176	28	826,576	33	200,777	11
U.S. Govt. Agency MBS	1,634,415	50	960,268	38	824,791	43
Non-Agency Whole Loans	20,275	1	37,899	2	142,399	7
Commercial MBS	1,717	—	3,236	—	6,514	—
Asset-backed Securities	35,254	1	65,319	3	113,400	6
Corporate Debt	—	—	—	—	94,866	5
Total Investment Securities*	2,832,716	87	2,153,118	86	1,663,323	87
Cash Equivalents						
Fed Funds	108,700	3	75,691	3	40,301	2
Master Notes	109,935	3	117,000	5	187,572	10
Repos	250,000	7	150,000	6	25,000	1
Total Cash Equivalents	468,635	13	342,691	14	252,873	13
Total Investment Portfolio	\$ 3,301,351	100%	\$2,495,809	100%	\$1,916,196	100%

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

As illustrated, in 2003, money market instruments (Commercial Paper, Fed Funds, Master Notes and Repos) represented 20 percent of the portfolio. U.S. Government and Agency-guaranteed mortgage securities made up an additional 78 percent of the portfolio. The remaining 2 percent of the portfolio, while not Government or Agency-guaranteed, consists of highly rated, liquid securities.

AgFirst, in conjunction with the other System Banks, has adopted a liquidity policy that established a "minimum coverage" level of 90 days. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2003, AgFirst's coverage was 134 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, 2003, AgFirst had \$14.5 billion in total debt outstanding compared to \$13.5 billion at December 31, 2002 and \$12.1 billion at December 31, 2001. The year-to-year increases were primarily due to the increases in loan volume and investments. Refer to Note 7, *Bonds and Notes*, for additional information related to debt.

Asset/Liability Management

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

options are offered, with the ability to pay on a monthly, quarterly, semi-annual or annual frequency. In addition, "custom" repayment plans may be negotiated to fit a borrower's unique circumstances.

The objective of the AgFirst asset/liability management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst's interest-earning assets and interest-bearing liabilities and simulation analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates. The following tables represent AgFirst's projected change in net interest income and market value of equity for various rate movements as of December 31, 2003.

Net Interest Income (dollars in thousands)				
Scenarios	Net Interest Income		% Change	
+400 BP Shock	\$190,310		1.49%	
+200 BP Shock	197,386		5.26%	
0 BP	187,519		—	
-47.5 BP Shock*	192,909		2.87%	

Market Value of Equity (dollars in thousands)				
Scenarios	Assets	Liabilities	Equity	% Change
Book Value	\$15,688,850	\$14,740,861	\$947,989	—
+400 BP Shock	14,529,316	13,963,726	565,590	(33.30%)
+200 BP Shock	15,060,006	14,358,528	701,478	(17.28%)
0 BP	15,614,668	14,766,646	848,022	—
-47.5 BP Shock*	15,744,290	14,859,739	884,551	4.31%

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

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS (continued)

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2003. The amount of assets and liabilities shown, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity, anticipated prepayments, and, in the case of liabilities, the exercise of call options.

	Repricing/Maturity Gap Analysis			
	Less than or Equal to 1 Year	Greater than 1 Year Less than 5 Years	Greater than or Equal to 5 Years	Total
(dollars in thousands)				
Short and Intermediate-Term Loans				
Fixed	\$ 753,304	\$ 311,370	\$ 73,265	\$ 1,137,939
Variable	3,763,588	—	—	3,763,588
Total Short and Intermediate-Term Loans	4,516,892	311,370	73,265	4,901,527
Long-Term Real Estate Loans				
Fixed	2,836,007	2,912,589	1,492,435	7,241,031
Variable	205,095	26,697	1,001	232,793
Total Long-Term Real Estate Loans	3,041,102	2,939,286	1,493,436	7,473,824
Total Loans	7,557,994	3,250,656	1,566,701	12,375,351
Cash and Investments	2,723,069	439,478	140,114	3,302,661
TOTAL INTEREST EARNING ASSETS	\$10,281,063	\$3,690,134	\$1,706,815	\$15,678,012
Source of Funds				
Interest Bearing Liabilities	\$10,430,105	\$3,897,000	\$ 180,000	\$14,507,105
Preferred Stock	—	—	225,000	225,000
Perpetual Preferred Stock	—	—	150,000	150,000
Interest Rate Swaps	415,000	(415,000)	—	—
Equity	—	—	804,532	804,532
TOTAL SOURCE OF FUNDS	\$10,845,105	\$3,482,000	\$1,359,532	\$15,686,637
Interest Rate Sensitivity Gap	\$ (564,041)	\$ 208,134	\$ 347,283	
Sensitivity Gap as a % of Total Earning Assets	(3.60%)	1.33%	2.22%	
Cumulative Gap	\$ (564,041)	\$ (355,907)	\$ (8,624)	
Cumulative Gap as a % of Total Earning Assets	(3.60%)	(2.27%)	(.06%)	
Rate Sensitive Assets/Rate Sensitive Liabilities	.95	1.06	1.26	

At December 31, 2003, approximately \$1.1 billion of callable bonds were “in the money,” resulting in the \$564 million liability sensitive position in the first tranche. Stable or falling rates would result in the bonds being called, resulting in further improvement in AgFirst’s net interest margin. Rising rates would simply result in the bonds not being called and liability-sensitive position would immediately shift toward an asset-sensitive position, as reflected in the net interest income sensitivity analysis above.

At December 31, 2003, AgFirst had outstanding interest rate swaps with notional amounts totaling \$1.166 billion and purchased interest rate caps with notional amounts totaling \$1.887 billion. These derivative transactions were executed to reduce interest rate risk and/or reduce funding costs.

AgFirst policy prohibits the use of derivatives for speculative purposes. Refer to Note 16, *Derivative Instruments and Hedging Activities*, in the notes to the consolidated financial statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2003.

Disclosures for Derivative Financial Instruments					
Notational amounts (dollars in millions)	Receive Fixed	Amortizing Floating for Floating	Interest Rate Caps	Other Derivative Products	Total
Balance at December 31, 2002	\$193	\$684	\$1,762	\$ —	\$2,639
Additions	465	—	100	54	619
Maturities/amortizations	(118)	(58)	(29)	—	(205)
Balance at December 31, 2003	\$540	\$626	\$1,833	\$ 54	\$3,053

Various uses of derivative instruments at December 31, 2003

(dollars in millions)	
Interest rate swaps utilized to create synthetic floating-rate debt to achieve a lower cost of funding	\$ 540
Asset/liability management purposes	2,126
Other purposes	387
Total interest rate swaps and caps outstanding	\$3,053

Preferred Stock

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

On October 14, 2003, AgFirst issued \$150,000 of Class A Perpetual Non-Cumulative Preferred Stock, Series 2 at a par value of \$1 thousand per share. Dividends on the stock are non-cumulative and payable on the 15th day of June and December in each year, commencing December 15, 2003, at an annual rate equal to 7.30 percent. In the event dividends are not declared on the preferred stock for payment on any dividend payment date, then such

dividends shall not cumulate and shall cease to accrue and be payable. On and after the dividend payment date in December 2008, the Bank may, at its option, redeem the preferred stock in whole or in part at any time at the redemption price of \$1 thousand per share plus accrued and unpaid dividends for then current dividend period to the date of redemption.

See Note 8, *Mandatorily Redeemable Preferred Stock*, and Note 9, *Shareholders’ Equity*, of the notes to the consolidated financial statements of this annual report for more detailed information concerning the preferred stock issuances.

Capital

Total shareholders’ equity at December 31, 2003 was \$954,532 compared to \$756,845 and \$727,948 at December 31, 2002 and 2001, respectively. The increasing trend in shareholders’ equity is attributed to the issuance of perpetual preferred stock in 2003 and increases in retained earnings, offset somewhat by a decrease in outstanding capital stock resulting from the redemption by AgFirst of a portion of its capital stock.

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS (continued)

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

	Regulatory Minimum	AgFirst Ratio as of		
		12/31/03	12/31/02	12/31/01
Permanent Capital Ratio	7.00%	25.99%	22.91%	20.70%
Total Surplus Ratio	7.00%	25.79%	22.69%	19.86%
Core Surplus Ratio	3.50%	14.45%	13.20%	10.39%
Collateral Ratio	103.00%	106.94%	105.94%	106.38%

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

Additionally, the permanent capital, total surplus, and core surplus ratios from December 31, 2001 to December 31, 2002 were enhanced by the accumulation of earnings, offset somewhat by asset growth.

Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-weighting of assets. The 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 consolidated financial statements for additional information.

Legal Proceedings

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

Recent Regulatory Matters

On February 24, 2004, the Farm Credit Administration published a final notice in the Federal Register that loan syndication transactions by System institutions to eligible borrowers must be treated as direct loans meeting all statutory and regulatory requirements, rather than as loan participations. In addition, the Farm Credit Administration indicated that since Farm Credit Banks can no longer make direct loans to eligible borrowers, they cannot directly take part in loan syndication transactions to eligible borrowers. Syndication transactions with certain entities whose operations are functionally similar to those of an eligible borrower are not impacted by the final notice. The Farm Credit Administration has included certain transitional provisions with respect to existing loan syndications to eligible borrowers. Future loan syndication transactions under the direct lending authorities will be required to have borrower rights, territorial concurrence and stock requirements attached to them. This development will not impact the ability of certain other System institutions to effectively compete in the syndication market in the future. As of December 31, 2003, loan syndication volume had no material impact on AgFirst's financial position.

ADDITIONAL DISCLOSURES REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

Description of Business

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

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

Description of Property

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

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

Legal Proceedings

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

Description of Capital Structure

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

Description of Liabilities

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

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

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

Senior Officers

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

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

Senior Officer	Position
F. A. (Andy) Lowrey	President and Chief Executive Officer
Thomas S. Welsh	Executive Vice President
William R. Clayton	Senior 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, 2003, 2002 and 2001, is as follows:

Name of Individual or Number in Group	Year	Annual		Deferred Comp.	Total
		Salary	Bonus		
F. A. (Andy) Lowrey	2003	\$ 377,534	\$105,710	\$26,427	\$ 509,671
F. A. (Andy) Lowrey	2002	\$ 343,213	\$102,964	\$ —	\$ 446,177
F. A. (Andy) Lowrey	2001	\$ 312,648	\$ 78,162	\$ —	\$ 390,810
5 Officers	2003	\$1,075,450	\$202,071	\$73,444	\$1,350,965
5 Officers	2002	\$1,087,203	\$289,658	\$ —	\$1,376,861
5 Officers	2001	\$1,001,801	\$233,532	\$ —	\$1,235,333

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 2003 bonus was made in the first quarter of 2004.

Disclosure of the total compensation in 2003 to any senior officer, or to any other individual included in the total whose compensation exceeds \$50,000, is available to shareholders upon request.

ADDITIONAL DISCLOSURES REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS (continued)

AgFirst Farm Credit Bank Board of Directors

(as of December 31, 2003)

Name	Position	Term of Office
Paul Lemoine	Chairman	December 31, 2003*
E. McDonald Berryman	Vice Chairman	December 31, 2005
William C. Bess, Jr.	Director	December 31, 2005
Dr. Chester D. Black	Director	December 31, 2006
Robert A. Carson	Director	December 31, 2006
R. Tommy Clay, Sr.	Director	December 31, 2004
Don W. Freeman	Director	December 31, 2005
Robert L. Holden, Sr.	Director	December 31, 2006
Paul M. House	Director	December 31, 2003*
Thomas W. Kelly	Director	December 31, 2004
Richard Kriebel	Director	December 31, 2003*
M. Wayne Lambertson	Director	December 31, 2005
F. Merrel Lust	Director	December 31, 2005
Eugene W. Merritt, Jr.	Director	December 31, 2006
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

* Each has been re-elected with new 4-year term ending 12/31/07.

Paul Lemoine, Chairman of the Board, is a cattle and row crop farmer from Plaquemine, Louisiana. He is active in a number of organizations related to farming, and is employed as a crop sales consultant with Agrilience Chemical Co. He is a member of the Louisiana Cattlemen's Association and the Avoyelles Parish Farm Bureau. During 2003, he served 27 days at AgFirst board meetings and 19 days at other official board functions, and was paid \$25,769 in compensation.

E. McDonald Berryman, Vice Chairman of the Board, is a farmer from Elberon, Virginia and is president of Beechland Farms, Inc., a family-owned and operated farm in Surry County, Virginia. His operations consist of 4,000 acres of row crops including peanuts, corn, wheat, soybeans and cotton, and also 1,000 acres of growing timber. He served as past president of Peanut Farmers LLC and is a member of the Surry County Farm Bureau. During 2003, he served 27 days at AgFirst board meetings and 17 days at other official board functions, and was paid \$25,769 in compensation.

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders and 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 2003, he served 27 days at AgFirst board meetings and 14 days at other official board functions, and was paid \$25,769 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 2003, he served 27 days at AgFirst board meetings and 14 days at other official board functions, and was paid \$25,769 in compensation.

Robert A. Carson, a row crop farmer in the Mississippi Delta, is active in a number of agricultural organizations. He is a director of the Delta Council and a member of the national Farm Credit Council Board. During 2003, he served 26 days at AgFirst board meetings and 10 days at other official board functions, and was paid \$25,769 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 served as a director of the Putnam County Fair and the Rodeheaver Boys Ranch. During 2003, he served 27 days at AgFirst board meetings and 10 days at other official board functions, and was paid \$25,769 in compensation.

Don W. Freeman is a farmer-rancher from Lowndesboro, Alabama. He is a member of Lowndes County Alabama Farmers Federation and Cattlemen's Association, and is past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers. During 2003, he served 27 days at AgFirst board meetings and 17 days at other official board functions, and was paid \$25,769 in compensation.

Robert L. Holden, Sr. is co-owner and operator of a dairy, a 900-acre row-crop farm, and a 200,000 broiler operation in Whigham, Georgia. He is a director of the Southwest Georgia Farm Credit, ACA, Georgia Milk Producers, and Grady County Farm Bureau. During 2003, he served 24 days at AgFirst board meetings and 13 days at other official board functions, and was paid \$25,769 in compensation.

Paul M. House is from Nokesville, Virginia, where he grows corn, soybeans, wheat, hay and turf grass. He also operates a dairy. He serves as a director of the Farm Credit of the Virginias, ACA. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 in compensation.

Thomas W. Kelly, from Tyrone, Pennsylvania, is owner-operator of a dairy and crop farm. The dairy herd consists of registered Holsteins whose genetics are merchandized. Major crops include corn, alfalfa, soybeans and seed barley. He currently serves on the board of AgChoice Farm Credit, ACA. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 in compensation.

Richard Kriebel is a contract crop farmer from Benton, Pennsylvania, raising contract forage and grain. His crops consist of 540 owned-and-leased acres (235 acres of corn and 305 acres of hay). He is a director of AgChoice Farm Credit, ACA, and a former member of the Columbia County ASCS, Columbia County Extension and the Columbia County Planning Commission. During 2003, he served 27 days at AgFirst board meetings and 13 days at other official board functions, and was paid \$25,769 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 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 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, son and nephew. He currently serves as a member of the board of Ag Credit ACA. During 2003, he served 24 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 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 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 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 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 in compensation.

J. Dan Raines, Jr. is a farmer from Ashburn, Georgia. His farming operations include beef cattle, registered Angus cattle and timber. He is a graduate of the University of Georgia, is a director on the board of AgGeorgia Farm Credit, ACA and the Federal Agricultural Mortgage Corporation (Farmer Mac). During 2003, he served 27 days at AgFirst board meetings and 19 days at other official board functions, and was paid \$25,769 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 2003, he served 27 days at AgFirst board meetings and 13 days at other official board functions, and was paid \$25,769 in compensation.

Robert G. Sexton is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association and co-owner of Orchid Island Juice Company. He serves as a director of Farm Credit of South Florida, ACA, Florida Citrus Packers, Indian River Citrus League, Highland Exchange Service Co-op and McArthur Management Company. In addition, he is a member of the Indian River Farm Bureau. During 2003, he served 23 days at AgFirst board meetings and 9 days at other official board functions, and was paid \$25,769 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 2003, he served 23 days at AgFirst board meetings and 12 days at other official board functions, and was paid \$25,769 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 \$181,020 for 2003, \$182,624 for 2002, and \$185,267 for 2001. 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 \$489,611 during 2003.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 to the consolidated financial statements, *Related Party Transactions*, included in this annual report to shareholders.

ADDITIONAL DISCLOSURES REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS (continued)

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.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 24, 2004, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Copies of the Bank's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. These reports can also be viewed or obtained by going to the Bank's website at www.agfirst.com.

REPORT OF INDEPENDENT AUDITORS



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

Report of Independent Auditors

February 24, 2004

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

We have audited the accompanying consolidated balance sheets of AgFirst Farm Credit Bank and its subsidiary as of December 31, 2003, 2002, and 2001, and the related consolidated statements of income, of changes in shareholders' equity, and of cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank and its subsidiary at December 31, 2003, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

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

PricewaterhouseCoopers LLP

CONSOLIDATED BALANCE SHEETS

46

<i>(dollars in thousands)</i>	December 31, 2003	December 31, 2002	December 31, 2001
Assets			
Cash and cash equivalents	\$ 469,945	\$ 359,819	\$ 265,254
Investment securities	2,832,716	2,153,118	1,663,323
Loans	12,375,351	12,008,041	11,128,810
Less: allowance for loan losses	34,168	31,155	25,616
Net loans	12,341,183	11,976,886	11,103,194
Accrued interest receivable	44,978	50,470	56,771
Investments in other Farm Credit System institutions	78,672	78,251	77,765
Premises and equipment, net	24,995	18,722	16,822
Due from associations	39,839	24,512	1,219
Other assets	47,220	39,412	49,057
Total assets	<u>\$15,879,548</u>	<u>\$14,701,190</u>	<u>\$13,233,405</u>
Liabilities			
Bonds and notes	\$14,507,105	\$13,538,536	\$12,115,709
Mandatorily redeemable preferred stock (Note 8)	225,000	—	—
Accrued interest and dividend payable	52,024	43,732	60,442
Patronage distribution payable	92,129	85,477	67,786
Postretirement benefits other than pensions	11,688	10,512	9,602
Minimum pension liability	8,751	10,449	—
Other liabilities	28,319	29,800	26,079
Total liabilities	<u>14,925,016</u>	<u>13,718,506</u>	<u>12,279,618</u>
Commitments and contingencies (Note 14)			
Mandatorily redeemable preferred stock (Note 8)	<u>—</u>	<u>225,839</u>	<u>225,839</u>
Shareholders' Equity			
Perpetual preferred stock (Note 9)	150,000	—	—
Capital stock and participation certificates	229,083	249,444	281,803
Retained earnings	601,699	527,673	439,104
Accumulated other comprehensive income (loss)	(26,250)	(20,272)	7,041
Total shareholders' equity	<u>954,532</u>	<u>756,845</u>	<u>727,948</u>
Total liabilities and equity	<u>\$15,879,548</u>	<u>\$14,701,190</u>	<u>\$13,233,405</u>

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

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands)	For the year ended December 31,		
	2003	2002	2001
Interest Income			
Investment securities and other	\$ 59,401	\$ 62,836	\$104,519
Loans	469,148	544,575	636,118
Total interest income	528,549	607,411	740,637
Interest Expense	284,492	351,751	555,855
Net interest income	244,057	255,660	184,782
Provision for loan losses	2,500	8,000	4,500
Net interest income after provision for loan losses	241,557	247,660	180,282
Noninterest Income			
Loan fees	8,856	9,744	11,483
Realized gains (losses) on investments, net	247	(1,388)	(4,798)
Secondary mortgage operations income (loss)	(1,445)	15,796	717
Other noninterest income	1,855	119	1,309
Total noninterest income	9,513	24,271	8,711
Noninterest Expenses			
Salaries and employee benefits	23,367	22,507	17,515
Occupancy and equipment	8,552	7,966	7,147
Insurance Fund premium	2,014	632	—
Other operating expenses	13,088	15,985	9,791
Intra-System financial assistance expenses	13,308	15,458	14,148
Called debt expense	11,736	13,518	9,615
Other noninterest expenses	1,556	1,732	171
Total noninterest expenses	73,621	77,798	58,387
Net income	\$177,449	\$194,133	\$130,606

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

48

<i>(dollars in thousands)</i>	Perpetual Preferred Stock	Capital Stock and Participation Certificates	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2000	\$ —	\$301,189	\$388,035	\$ (1,450)	\$687,774
Comprehensive income					
Cumulative effect of a change in accounting for derivatives				(1,037)	(1,037)
Net income			130,606		130,606
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of \$(4,798)				12,588	12,588
Change in fair value of derivative instruments				(3,060)	(3,060)
Total comprehensive income					139,097
Capital stock/participation certificates issued/retired, net		(19,386)			(19,386)
Mandatorily redeemable preferred stock dividends accrued			(11,751)		(11,751)
Cash distributions			(67,786)		(67,786)
Balance at December 31, 2001	—	281,803	439,104	7,041	727,948
Comprehensive income					
Net income			194,133		194,133
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of \$(1,388)				6,856	6,856
Change in fair value of derivative instruments				(16,782)	(16,782)
Minimum pension liability adjustment				(17,387)	(17,387)
Total comprehensive income					166,820
Capital stock/participation certificates issued/retired, net		(32,359)			(32,359)
Mandatorily redeemable preferred stock dividends accrued			(18,887)		(18,887)
Cash distributions			(86,677)		(86,677)
Balance at December 31, 2002	—	249,444	527,673	(20,272)	756,845
Comprehensive income					
Net income			177,449		177,449
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of \$247				(9,480)	(9,480)
Change in fair value of derivative instruments				2,116	2,116
Minimum pension liability adjustment				1,386	1,386
Total comprehensive income					171,471
Perpetual preferred stock issued	150,000				150,000
Capital stock/participation certificates issued/retired, net		(20,361)			(20,361)
Perpetual preferred stock dividends paid			(1,851)		(1,851)
Mandatorily redeemable preferred stock dividends accrued			(9,443)		(9,443)
Cash distributions			(92,129)		(92,129)
Balance at December 31, 2003	\$150,000	\$229,083	\$601,699	\$(26,250)	\$954,532

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	For the year ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net income	\$ 177,449	\$ 194,133	\$ 130,606
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	4,955	4,130	2,731
Provision for loan losses	2,500	8,000	4,500
Realized (gains) losses on investments, net	(247)	1,388	4,798
Realized (gains) losses on mortgage loans held for sale	1,859	(14,301)	—
Proceeds from sale of mortgage loans held for sale	754,486	806,473	—
Purchases of mortgage loans held for sale (net of principal repayment)	(667,196)	(531,977)	(346,122)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	5,492	6,301	15,330
(Increase) decrease in investments in other Farm Credit System institutions	(421)	(486)	858
(Increase) decrease in other assets	(23,135)	(13,648)	(13,551)
Increase (decrease) in accrued interest and dividend payable	8,292	(16,710)	(60,266)
Increase (decrease) in postretirement benefits other than pensions	1,176	910	538
Increase (decrease) in minimum pension liability	(1,698)	10,449	—
Increase (decrease) in other liabilities	(95)	(13,666)	5,416
Total adjustments	85,968	246,863	(385,768)
Net cash provided by (used in) operating activities	263,417	440,996	(255,162)
Cash flows from investing activities:			
Investment securities purchased	(4,826,206)	(3,040,275)	(2,346,707)
Investment securities sold or matured	4,137,375	2,555,948	2,691,260
Net (increase) decrease in loans	(454,746)	(1,143,087)	(1,286,485)
Purchase of premises and equipment, net	(11,228)	(6,030)	(9,664)
Net cash used in investing activities	(1,154,805)	(1,633,444)	(951,596)
Cash flows from financing activities:			
Bonds and notes issued	57,612,055	49,737,367	44,526,761
Bonds and notes retired	(56,641,370)	(48,331,322)	(43,429,706)
Perpetual preferred stock issued	150,000	—	—
Mandatorily redeemable preferred stock issued	—	—	225,000
Capital stock and participation certificates issued/retired, net	(20,361)	(32,359)	(19,386)
Cash distributions to shareholders	(86,677)	(67,786)	(61,333)
Dividends paid on perpetual preferred stock	(1,851)	—	—
Dividends paid on mandatorily redeemable preferred stock	(10,282)	(18,887)	(10,912)
Net cash provided by financing activities	1,001,514	1,287,013	1,230,424
Net increase (decrease) in cash and cash equivalents	110,126	94,565	23,666
Cash and cash equivalents, beginning of period	359,819	265,254	241,588
Cash and cash equivalents, end of period	\$ 469,945	\$ 359,819	\$ 265,254
Supplemental schedule of non-cash investing and financing activities:			
Change in unrealized gains (losses) on investments	\$ (9,480)	\$ 6,856	\$ 12,588
Change in fair value of derivative instruments	2,116	(16,782)	(3,060)
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	\$ (1,894)	\$ (1,024)	\$ 3,199
Increase (decrease) in bonds and notes	1,082	(8,478)	9,610
Decrease (increase) in other assets	(1,564)	9,328	(11,248)
Increase (decrease) in other liabilities	(3,107)	561	5,735
Supplemental information:			
Interest paid	\$ 276,200	\$ 368,461	\$ 616,121

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

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

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

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as Associations. AgFirst and its related associations (District Associations) are collectively referred to as the District. The District Associations jointly own a substantial portion of all voting stock in AgFirst. As of December 31, 2003, the District consisted of the Bank and twenty-four District ACAs. Twenty-two District Associations have restructured as holding companies, which includes twenty-two FLCA and PCA subsidiaries.

Effective January 1, 2004, two District ACAs merged, resulting in a total of twenty-three ACAs.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The

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

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

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

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

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

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

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

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

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

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

■ **Farm Credit Leasing Services Corporation** — provides a variety of leasing services for agricultural-related equipment and facilities. See Note 14.

■ **Farm Credit System Association Captive Insurance Company** — being a reciprocal insurer, provides insurance services to its member organizations.

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

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Bank conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires the management of the Bank to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results can differ from these estimates. Certain amounts in

prior years' financial statements have been reclassified to conform to the current year's presentation.

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

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

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

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

C. **Loans and Allowance for Loan Losses:** 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.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

Statement of Financial Accounting Standards No. 91 (SFAS No. 91), *Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans and Initial Direct Costs of Leases*, requires loan origination fees and direct loan origination costs, 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 the Bank because the effects are considered by management to not be material to the financial position or results of operations of the Bank.

The allowance for loan losses is management's best estimate of the amount of probable loan losses in its loan portfolio. AgFirst determines its allowance for loan losses based upon periodic evaluation of its loan portfolio, which generally considers type of loan, its credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors. Loan principal and interest, when appropriate, are charged against the allowance for loan losses if collection is unlikely.

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

A specific allowance may be established for impaired loans under SFAS No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

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 their impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

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

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

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

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

F. Employee Benefit Plans: Bank employees participate in a districtwide defined benefit retirement plan (the Plan) 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 at the Plan's measurement date (September 30) of the underlying Plan, the Bank may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

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

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

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

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

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

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) specific assets or liabilities on the balance sheet or (2) firm commitments or forecasted transactions. The Bank also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. The Bank uses regression analysis (or other statistical analysis) to assess the effectiveness of its hedges. The Bank discontinues hedge accounting prospectively when the Bank

determines that a hedge has not been or is not expected to be effective as a hedge. For cash flow hedges, any remaining accumulated other comprehensive income (loss) would be amortized into earnings over the remaining life of the original hedged item. For fair value hedges, changes in the fair value of the derivative will be recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

54

J. Recent Accounting Developments: In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The Interpretation elaborates on the disclosures to be made by a guarantor in its financial statements under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of the Interpretation were adopted by the Bank as of December 31, 2002, and require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee, and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The recognition requirements of the Interpretation were effective beginning January 1, 2003. The initial implementation of the Interpretation did not have a significant effect on the Bank's consolidated financial position or consolidated results of operations and management does not anticipate any such impact in the future.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. The Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The Statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. In addition, the provisions of the Statement, with certain exceptions, were required to be applied prospectively. The initial implementation of the Statement did not have a material effect on the Bank's consolidated financial position or consolidated results of operations, and management does not anticipate any such impact in the future.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 applies specifically to a number of financial instruments that companies have historically presented within their financial statements either as equity or between the liabilities section and the equity section, rather than as liabilities. On November 7, 2003, the FASB issued FASB Staff Position (FSP) 150-3, *Effective Date and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities*. FSP 150-3 defers the effective date of certain provisions of SFAS No. 150, specifically the provisions that apply to mandatorily redeemable noncontrolling interests. This deferral is expected to remain in effect indefinitely until the accounting for these interests is addressed in later guidance. The remaining provisions of SFAS No. 150 were effective for financial

instruments entered into or modified after May 31, 2003, and otherwise were effective and adopted by the Bank on July 1, 2003. As a result of adoption, effective July 1, 2003, the Bank's mandatorily redeemable preferred stock of \$225 million was reclassified to liabilities and the related dividends paid on that stock are treated as interest expense beginning July 1, 2003 rather than as a direct reduction of unallocated surplus. See Note 8 for further discussion.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Postretirement Benefits*. This Statement requires additional disclosures about the assets, obligations and cash flows of defined benefit pension and postretirement plans, as well as the expense recorded for such plans. As of December 31, 2003, the Bank has disclosed the required elements related to its benefit plans in Note 10 of the notes to the consolidated financial statements.

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

Note 3 — Investment Securities

A summary of the amortized cost and fair value of debt securities held as investments at December 31, 2003, 2002 and 2001, is as follows:

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

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

	December 31, 2001				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	\$ 280,555	\$ 23	\$ (2)	\$ 280,576	2.15%
U.S. Govt. GNMA					
MBS/CMOs	196,515	4,333	(71)	200,777	5.71
U.S. Govt. Agency MBS	818,942	10,095	(4,246)	824,791	4.76
Non-Agency Whole Loans	141,447	1,999	(1,047)	142,399	5.10
Commercial MBS	6,517	—	(3)	6,514	2.27
Asset-backed Securities*	208,209	79	(22)	208,266	2.55
Total Investment Securities	\$1,652,185	\$16,529	\$(5,391)	\$1,663,323	4.17%

*Includes corporate debt

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

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2003, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 229,881	\$ 229,879	1.08%
After one year through five years	—	—	
After five years through ten years	—	—	
After ten years	914,234	928,917	2.65
Collateralized mortgage obligations	1,680,088	1,673,920	1.61
Total	\$2,824,203	\$2,832,716	2.21%

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,		
	2003	2002	2001
Proceeds on sales	\$ 69,242	\$ 92,510	\$ 460,356
Realized gains	247	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,		
	2003	2002	2001
Direct notes receivable			
from District Associations	\$10,592,325	\$10,033,923	\$ 8,913,269
Participations, net	1,554,762	1,631,311	1,556,413
Mortgage loans purchased			
in the secondary market	228,046	344,383	661,648
SEAS No. 133 Adjustment	(282)	(2,176)	(3,199)
Other	500	600	679
Total	\$12,375,351	\$12,008,041	\$11,128,810

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

Total Association loans consisted of the following commodity types:

Commodity Group	Percent of Portfolio		
	2003	2002	2001
Poultry	13%	13%	15%
Forestry	12	11	9
Grain	10	9	10
Cattle	9	8	9
Dairy	8	7	7
Fruits/Vegetables	5	5	6
Nursery/Greenhouse	5	5	5
Processing	4	5	2
Rural Home	4	4	6
Swine	3	4	4
Tobacco	4	4	6
Citrus	3	4	3
Cotton	3	4	5
Other	17	17	13
Total	100%	100%	100%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

56

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.

	2003	December 31, 2002	2001
Nonaccrual:			
Current as to principal and interest	\$11,401	\$20,097	\$ 427
Past due	20,017	3,466	277
Accrual:			
Restructured	—	—	—
90 days or more past due	6,084	3,806	2,742
Total impaired loans	\$37,502	\$27,369	\$ 3,446

The average recorded investment in impaired loans during 2003, 2002 and 2001 was \$31,619, \$28,868 and \$643, respectively. Impaired loans of \$31,418, \$23,563 and \$704 at December 31, 2003, 2002 and 2001 had a specific allowance for loan losses totaling \$12,700, \$6,000 and \$0, respectively.

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

	2003	Year Ended December 31, 2002	2001
Balance at beginning of year	\$31,155	\$25,616	\$21,416
Provision for loan losses	2,500	8,000	4,500
Loans charged off	(67)	(2,522)	(300)
Recoveries	580	61	—
Balance at end of year	\$34,168	\$31,155	\$25,616

To mitigate risk of loan losses, District Associations have entered into long-term standby commitments to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac) through an arrangement with the Bank. The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Associations the right to sell the loans identified in the agreements to the Bank, who can, in turn, sell them to Farmer Mac in the event of default, subject to certain conditions. The balance of loans under long-term standby commitments to purchase was \$431 million at December 31, 2003. Fees paid to Farmer Mac for such commitments are paid by the Associations.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	2003	December 31, 2002	2001
Land	\$ 848	\$ 848	\$ 848
Buildings and improvements	3,932	3,300	3,151
Furniture and equipment	30,750	28,002	25,775
Work in progress	7,895	3,048	69
	43,435	35,198	29,843
Less: accumulated depreciation	18,430	16,476	13,021
Total	\$24,995	\$18,722	\$16,822

Note 6 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	2003	December 31, 2002	2001
Other assets:			
Unamortized debt issue costs	\$ 9,109	\$ 7,168	\$ 5,494
Prepaid retirement expenses	—	—	8,845
Intangible asset related to pension	1,583	1,797	—
Deferred issuance costs – preferred stock	3,974	2,331	2,608
Derivative assets	3,484	1,920	11,248
Receivables and other	29,070	26,196	20,862
Total	\$47,220	\$39,412	\$49,057
Other liabilities:			
Accounts payable	\$ 2,349	\$ 1,378	\$ 2,684
Farm Credit System Ins. Corp. payable	16,171	4,047	—
Financial Assistance Corporation payable	28	8,087	8,959
Derivative liabilities	3,188	6,295	5,734
Other	6,583	9,993	8,702
Total	\$28,319	\$29,800	\$26,079

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. The MAA was amended and restated in July, 2003. At December 31, 2003, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide debt securities.

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

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

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

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

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

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

AgFirst's participation in 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
2004	1.24%	\$ 4,452,194	—%	\$ —	.99%	\$1,758,352	1.17%	\$6,210,546
2005	1.42	3,133,179	—	—	—	—	1.42	3,133,179
2006	2.17	1,878,846	6.33	10,845	—	—	2.19	1,889,691
2007	3.01	1,000,911	—	—	—	—	3.01	1,000,911
2008	2.90	1,082,582	—	—	—	—	2.90	1,082,582
2009	4.49	1,190,196	—	—	—	—	4.49	1,190,196
Total	2.01%	\$12,737,908	6.33%	\$10,845	.99%	\$1,758,352	1.88%	\$14,507,105

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, 2003, was 34 days.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

58

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

Amount	First Call Date	Year of Maturity
\$6,073,000	2004	2004-2018
40,000	2005	2006
<u>\$6,133,000</u>		

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

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide debt securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund; all other liabilities on the financial statements are uninsured. At December 31, 2003 the assets of the Insurance Fund aggregated \$2.033 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, 2003, available funds in the Trust Fund amounted to \$73.8 million.

Note 8 — Mandatorily Redeemable Preferred Stock

As of December 31, 2003, AgFirst had 225,000 shares issued and outstanding of Mandatorily Redeemable Cumulative Preferred Stock at a par value of \$1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable semi-annually in arrears on the 15th day of June and December of each year at an annual rate equal to 8.393 percent of the \$1 thousand per share par value. Beginning March 15, 2012, the rate will change to a floating rate indexed to the 3-month LIBOR. On or after the dividend payment date in December 15, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of \$1 thousand per share. As discussed in Note 2, beginning in July 1, 2003, the Mandatorily Redeemable Preferred Stock was required to be reported prospectively as a liability and the related dividends reported prospectively as interest expense in accordance with SFAS No. 150. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes.

Note 9 — Shareholders' Equity

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

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

The Bank had the following shares of common equities outstanding at December 31, 2003:

Protected Class	Status	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	No	2,493,421	\$ 12,467
C Common/Voting	No	40,911,503	204,557
D Common/Nonvoting	No	2,306,122	11,531
Participation Certificates/Nonvoting	No	105,600	528
Total Capital Stock and Participation Certificates		45,816,646	\$229,083

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

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

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

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

Class D Common Stock shall also be purchased by borrowers eligible to hold it as a condition for obtaining a loan in an amount as may be determined by the Board at its discretion.

within a range between a minimum of two percent (2%) of the loan amount or \$1,000.00, whichever is less, and a maximum not to exceed ten percent (10%) of the loan amount. The Bank currently has no such loans outstanding.

- D. Other Equity:** At the inception of each Other Financing Institution (OFI) loan, the Bank requires OFIs to make cash purchases of participation certificates in the Bank. The Bank has a first lien on these equities for the repayment of any indebtedness to the Bank.
- E. Regulatory Capitalization Requirements and Restrictions:** FCA's capital adequacy regulations require the Bank to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. The Bank is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA Regulations also require all System institutions to achieve and maintain additional capital adequacy ratios as defined by FCA Regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Bank's permanent capital, total surplus and core surplus ratios at December 31, 2003 were 25.99 percent, 25.79 percent and 14.45 percent, respectively.

Capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104 percent compared to the regulatory minimum of 103 percent. At December 31, 2003, the Bank's net collateral ratio was 106.94 percent.

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

Note 10 — Employee Benefit Plans

The Bank participates in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Bank employees. For participants hired prior to January 1, 2003, benefits are based on eligible compensation and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the

District's salary expense. For participants hired on or after January 1, 2003, benefits are determined using a cash balance formula. This formula is based on employer contributions (3-5% of eligible compensation depending on years of service) and interest credits as allocated to an employee's theoretical account balance. The measurement date for the plan is September 30.

At December 31, 2003 and 2002, the Accumulated Benefit Obligation (ABO) of the District's defined benefit plan (the Plan) exceeded the fair value of plan assets. In accordance with the provisions of SEAS No. 87, *Employers' Accounting for Pensions*, (SEAS 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, 2003 and 2002, a minimum liability for the Bank was recognized in the amounts of \$8,751 and \$10,449, respectively.

The Bank also participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Bank contributes \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Bank contributes \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. The financial statements and disclosures do not reflect the effects of the Act. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require changes to previously reported information.

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

	2003	2002	2001
Pension	\$ 3,560	\$ 2,452	\$ 254
Thrift/deferred compensation	425	383	325
Other postretirement benefits	2,595	2,025	1,634
Total	\$ 6,580	\$ 4,860	\$ 2,213

Note 11 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

through the Financial Assistance Corporation's issuance of \$1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent.

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

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

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

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

the financial assistance payments and expenses over a number of years and accordingly gradually reduces the effect of the unrecorded liability. Management considers the current and future effect of not recording the liability to be immaterial to the Bank's financial condition and results of operations.

The Bank's financial assistance expense totaled \$13 million, \$15 million and \$14 million in 2003, 2002 and 2001, respectively.

Note 12 — Related Party Transactions

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

Interest income recognized on direct notes receivable from District Associations was \$396,136, \$438,233 and \$513,919 for 2003, 2002 and 2001, respectively.

Note 13 — Regulatory Enforcement Matters

At December 31, 2003, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 14 — Commitments and Contingencies

The Bank has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to the consolidated financial statements. While primarily liable for its portion of bonds and notes, the Bank is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2003, were \$94.2 billion.

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

Standby letters of credit are unconditional commitments issued by the Bank to guarantee the performance of a customer to a third party. As of December 31, 2003, the Bank had \$17.7 million letters of credit issued on behalf of Association customers. Of the outstanding amount, \$2.9 million will expire in less than one year, \$14.3 million are due to expire in one to three years and the remaining \$458 thousand have terms that will expire in 2011. The Bank also guarantees letters of credit with commercial banks on behalf of certain District Associations in the amount of \$4.8 million.

In addition, the Bank had \$63.4 million in letters of credit issued on behalf of non-district entities with \$5.9 million expiring in less than one year, \$51.1 million due to expire in one to three years and

the remaining \$6.4 million have terms that will expire from 2008 to 2011.

The Bank also guarantees certain loans held by District Associations in the amount of \$25.4 million with terms expiring from 2004 to 2024. The notional amounts of these guarantees represent the maximum amount of exposure the Bank has related to these instruments as of December 31, 2003.

At December 31, 2003, \$855.7 million 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 at December 31, 2003 owned 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 guaranteed its 18 percent pro rata share of FCLSC's note payable to CoBank. At December 31, 2003, the Bank's portion of the FCLSC note payable to CoBank

totaled \$124.2 million. As of January 1, 2004, AgFirst sold its ownership interest to CoBank and eliminated its contingent liability.

As of December 31, 2003, AgFirst also indemnifies leases in the amount of \$4.1 million on behalf of FCLSC with lease terms expiring in 2009.

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

Note 15 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Bank's financial instruments at December 31, 2003, 2002 and 2001. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

	December 31, 2003		December 31, 2002		December 31, 2001	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	\$12,375,351	\$11,742,568	\$12,008,041	\$11,924,081	\$11,128,810	\$10,993,159
Allowance for loan losses	(34,168)	—	(31,155)	—	(25,616)	—
Loans, net	\$12,341,183	\$11,742,568	\$11,976,886	\$11,924,081	\$11,103,194	\$10,993,159
Derivative assets	\$ 3,484	\$ 3,484	\$ 1,920	\$ 1,920	\$ 11,248	\$ 11,248
Cash & investment securities	\$ 3,302,661	\$ 3,302,661	\$ 2,512,937	\$ 2,512,937	\$ 1,928,577	\$ 1,928,577
Financial liabilities:						
Systemwide debt securities	\$14,507,105	\$14,475,670	\$13,538,536	\$13,223,005	\$12,115,709	\$12,134,913
Financial assistance related liabilities*	\$ 78	\$ 2,660	\$ 8,087	\$ 10,918	\$ 8,959	\$ 12,575
Derivative liabilities	\$ 3,188	\$ 3,188	\$ 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. The obligation was paid in July 2003.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

- A. **Loans:** Because no active market exists for the Bank's loans, fair value is estimated by discounting the expected future cash flows using the Bank's current interest rates at which similar loans would be made to borrowers with similar credit risk. Since the discount rates are based on the Bank's loan rates as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.
- For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool. Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. The carrying value of accrued interest approximates its fair value.
- B. **Cash, Federal Funds and Securities Purchased Under Resale Agreements:** The carrying value is a reasonable estimate of fair value.
- C. **Investment Securities:** Fair value is based upon currently quoted market prices.
- D. **Systemwide Debt Securities:** Bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity Treasury notes, assuming a constant estimated spread relationship between Systemwide bonds and notes and comparable Treasury notes.
- E. **Financial Assistance Related Liabilities:** As discussed in Note 11, the District is liable for certain obligations of the Financial Assistance Corporation, one of which is unrecorded. Fair value of these obligations is determined by discounting the cumulative expected future cash outflows of all of the obligations using an interest rate commensurate with bonds having a similar maturity.
- F. **Derivative Instruments:** The fair value of derivatives is the estimated amount to be received or paid to replace the instruments at the reporting date, considering current and projected interest rates. Where actively quoted market prices do not exist, estimated fair values are determined through dealer quotes.
- G. **Commitments to Extend Credit and Standby Letters of Credit:** The fair value of commitments is estimated using the fees currently charged to enter similar agreements, taking into

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

Note 16 — Derivative Instruments and Hedging Activities

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

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

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

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

To minimize the risk of credit losses, the Bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing of and levels of exposure to individual counterparties. The estimated credit risk exposure of \$5.1 million with seven counterparties represents approximately .16 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, 2003, the Bank had not posted collateral with respect to these arrangements.

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

Note 17 — Additional Derivative Financial Instruments and Other Financial Instruments Disclosures

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

	Maturities of 2003 Derivative Products and Other Financial Instruments							
<i>December 31, 2003</i> <i>(dollars in millions)</i>	2004	2005	2006	2007	2008	After 2009	Total	Fair Value
Systemwide Debt Securities:								
Fixed rate	\$ 3,505	\$ 1,544	\$ 1,399	\$ 901	\$ 807	\$ 1,190	\$ 9,346	\$ 9,222
Weighted average interest rate	1.28%	1.78%	2.58%	3.22%	3.51%	4.49%	2.81%	
Variable rate	2,510	1,589	490	100	276	—	4,965	5,024
Weighted average interest rate	1.04%	1.06	1.08	1.09	1.10	—	.90%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	\$ 75	\$ 25	\$ 275	\$ 25	\$ 140	\$ —	\$ 540	\$ 2
Weighted average receive rate	2.48%	1.74%	2.55%	3.50%	3.37%	—	2.76%	
Weighted average pay rate	1.00%	1.03%	1.17%	1.03%	1.03%	—	1.10%	
Amortizing floating for floating swaps								
Notional value	81	233	312	—	—	—	626	(2)
Weighted average receive rate	2.16%	1.69%	1.22%	—	—	—	1.52%	
Weighted average pay rate	4.38%	2.56%	1.34%	—	—	—	2.19%	
Interest rate caps								
Notional value	—	1,569	264	—	—	—	1,833	2
Other derivative products								
Notional value — TBA's	54	—	—	—	—	—	54	—
Total notional value	\$ 210	\$ 1,827	\$ 851	\$ 25	\$ 140	\$ —	\$ 3,053	\$ 2
Total weighted average rates on swaps:								
Receive rate	2.31%	1.69%	1.84%	3.50%	3.37%	—%	2.09%	
Pay rate	2.76%	2.41%	1.26%	1.03%	1.03%	—%	1.67%	
<i>(dollars in millions)</i>	Less than 1 year	1 to 5 Years	Over 5 Years	Maturity Distribution Netting	Exposure	Collateral Held	Exposure Net of Collateral	
Credit Rating								
AAA	\$ —	\$ 1	\$ —	\$ (1)	\$ —	\$ —	\$ —	
AA	—	1	—	—	1	—	1	
A	—	1	—	—	1	—	1	
Total	\$ —	\$ 3	\$ —	\$ (1)	\$ 2	\$ —	\$ 2	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

64

Note 18 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2003, 2002 and 2001 follow:

	2003				
	First	Second	Third	Fourth	Total
Net interest income	\$ 66,320	\$ 65,563	\$ 56,168	\$ 56,006	\$244,057
Provision for loan losses	2,500	—	—	—	2,500
Noninterest income (expense), net	(12,663)	(19,981)	(17,658)	(13,806)	(64,108)
Net income	\$ 51,157	\$ 45,582	\$ 38,510	\$ 42,200	\$177,449
	2002				
	First	Second	Third	Fourth	Total
Net interest income	\$ 61,108	\$ 63,104	\$ 64,775	\$ 66,673	\$255,660
Provision for loan losses	1,000	1,000	—	6,000	8,000
Noninterest income (expense), net	(16,648)	(10,961)	(15,989)	(9,929)	(53,527)
Net income	\$ 43,460	\$ 51,143	\$ 48,786	\$ 50,744	\$194,133
	2001				
	First	Second	Third	Fourth	Total
Net interest income	\$ 35,061	\$ 40,993	\$ 49,245	\$ 59,483	\$184,782
Provision for loan losses	1,000	—	2,000	1,500	4,500
Noninterest income (expense), net	(8,544)	(9,661)	(18,353)	(13,118)	(49,676)
Net income	\$ 25,517	\$ 31,332	\$ 28,892	\$ 44,865	\$130,606

Note 19 — Combined Associations Financial Data (Unaudited)

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

Balance Sheet

	2003	December 31,	
		2002	2001
Cash	\$ 24,394	\$ 24,568	\$ 27,710
Loans	12,585,671	11,902,688	10,709,497
Less: allowance for loan losses	282,567	280,025	275,999
Net loans	12,303,104	11,622,663	10,433,498
Investment in other Farm Credit institutions	217,051	237,051	268,397
Other assets	306,076	320,588	348,519
Total assets	\$12,850,625	\$12,204,870	\$11,078,124
Notes payable to AgFirst Farm Credit Bank	\$10,592,822	\$10,034,188	\$8,916,205
Postretirement benefits other than pensions	67,085	56,680	50,714
Minimum pension liability	48,408	51,373	—
Other liabilities	260,397	241,167	229,540
Total liabilities	10,968,712	10,383,408	9,196,459
Protected borrowers equity	12,453	15,486	19,492
Capital stock and participation certificates	175,581	171,663	171,803
Retained earnings			
Allocated	792,168	756,525	733,378
Unallocated	984,384	968,171	956,992
Accumulated other comprehensive (loss)	(82,673)	(90,383)	—
Total shareholders' equity	1,881,913	1,821,462	1,881,665
Total liabilities and equity	\$12,850,625	\$12,204,870	\$11,078,124

Statement of Income

	Year Ended December 31,		
	2003	2002	2001
Interest income	\$ 723,994	\$ 734,649	\$ 815,357
Interest expense	396,227	441,242	515,808
Net interest income	327,767	293,407	299,549
Provision for loan losses	5,653	17,263	15,796
Net interest income after provision for loan losses	322,114	276,144	283,753
Noninterest income	135,931	123,025	108,953
Noninterest expenses			
Salaries and employee benefits	150,476	129,971	113,759
Occupancy and equipment	15,951	15,782	15,711
Insurance Fund Premium	14,166	3,414	—
Other operating expenses	44,964	43,418	41,748
Total noninterest expenses	225,557	192,585	171,218
Income before income taxes	232,488	206,584	221,488
Provision (benefit) for income taxes	858	4,183	(19,410)
Net income	\$ 231,630	\$ 202,401	\$ 240,898

AGFIRST LEADERSHIP

Management

F. A. (Andy) Lowrey	President and Chief Executive Officer
Thomas S. Welsh	Executive Vice President
William R. Clayton	Senior Vice President

Board of Directors

Paul Lemoine	Chairman
E. McDonald Berryman	Vice Chairman
William C. Bess, Jr.	Director
Dr. Chester D. Black	Director
Robert A. Carson	Director
R. Tommy Clay, Sr.	Director
Don W. Freeman	Director
Robert L. Holden, Sr.	Director
Paul M. House	Director
Thomas W. Kelly	Director
Richard Kriebel	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



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

FINANCIAL REPORTING

wanda martin | jay wise | patti trotter | gloria hawkins | anita alexander | deborah lucas | rowena arroyo



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