Valley Farm Credit, ACA

SECOND QUARTER 2005

Robert N. Carpenter
Chief Executive Officer

Charles W. Kackley
Chairman of the Board

July 29, 2005

Valley Farm Credit, ACA

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

(dollars in thousands)

The following commentary reviews the financial condition and results of the consolidated operations of Valley Farm Credit, ACA, Valley Farm Credit, FLCA and Valley Farm Credit, PCA (Association) for the period ended June 30, 2005. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements, and the 2004 Annual Report of the Association.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including livestock, poultry, beef, orchards, dairy and rural home loans. Those major farm commodities totaled approximately $121,305 or 67.33 percent of the loan volume as of June 30, 2005. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat impacts the level of dependency on a given commodity.

The gross loan volume of the Association as of June 30, 2005 was $174,048, an increase of $2,280 as compared to $171,768 at December 31, 2004. Net loans outstanding at June 30, 2005 were $173,220 as compared to $170,940 at December 31, 2004. Net loans accounted for 93.80 percent of total assets at June 30, 2005 as compared to 93.79 percent of total assets at December 31, 2004.

The increase in gross and net loan volume during the reporting period is attributed primarily to new loans to several different sectors of the Association's agricultural portfolio, new loans to the residential portion of the portfolio, and participation loans purchased.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, and credit administration remains satisfactory. Nonaccrual loans were $0 at June 30, 2005 and December 31, 2004. Association management maintains an allowance for loan losses in an amount sufficient to absorb losses inherent in the loan portfolio at the balance sheet date based on current conditions. The allowance for loan losses was $828 at June 30, 2005 and at December 31, 2004, and was considered by management to be adequate.

RESULTS OF OPERATIONS

For the three months ended June 30, 2005

Net income for the three months ended June 30, 2005, totaled $949, as compared to $340 for the same period in 2004. Net interest income increased $125 for the three months ended June 30, 2005 as compared to the same period in 2004.

At June 30, 2005 interest income on loans increased $447 as compared to the same period in 2004. Nonaccrual income was $0 for the three months ended June 30, 2005 and for the same period in 2004. Interest expense increased $322 for the three months ended June 30, 2005 as compared to the comparable period of 2004. Noninterest income for the three months ended June 30, 2005 totaled $1,222 as compared to $577 for the same period of 2004, an increase of $645. Total noninterest income includes the gain on sale of assets in the amount of $507 during the three months ended June 30, 2005, which is related to the sale of property located in Martinsburg, WV. Noninterest expense for the three months ended June 30, 2005 increased $161 compared to the same period of 2004. There was no provision (benefit) for income taxes at June 30, 2005 or the same period in 2004.

For the six months ended June 30, 2005

Net income for the six months ended June 30, 2005, totaled $1,229, as compared to $562 for the same period in 2004. Net interest income increased $233 for the six months ended June 30, 2005 as compared to the same period in 2004.

At June 30, 2005 interest income on loans increased $853 as compared to the same period in 2004. Nonaccrual income was $0 for the six months ended June 30, 2005 and for the same period in 2004. Interest expense increased $620 for the six months ended June 30, 2005 as compared to the comparable period of 2004. Noninterest income for the six months ended June 30, 2005 totaled $1,881 as compared to $1,123 for the same period in 2004, an increase of $758. Total noninterest income includes the gain on sale of assets in the amount of $507 during the six months ended June 30, 2005, which is related to the sale of property located in Martinsburg, WV. Noninterest expense for the six months ended June 30, 2005 increased $324 compared to the same period in 2004. The increase during the reporting period is mostly attributed to additional staffing and increased advertising expenses. There was no provision (benefit) for income taxes at June 30, 2005 or the same period in 2004.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2005 was $159,663 as compared to $157,765 at December 31, 2004. The increase during the period is primarily attributed to an increase in loan volume.

CAPITAL RESOURCES

Total members' equity at June 30, 2005 increased to $21,879 from the December 31, 2004 total of $21,197. The rise in members' equity is attributed to the increase in retained earnings in excess of the reduction in capital stock and participation certificates.

Total capital stock and participation certificates were $3,903 on June 30, 2005 compared to $3,924 on December 31, 2004. This decrease is attributed to the retirement of stock and participation certificates on loans liquidated in the normal course of business and new loans being capitalized at lower stock levels.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2005, the Association's total surplus ratio and core surplus ratio were 10.43 percent and 9.31 percent, respectively, and the permanent capital ratio was 13.07 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

NOTE: Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, *www.agfirst.com*. Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-999-5341 or writing Mary S. Miller, Vice President and CFO, Valley Farm Credit, ACA, P.O. Box 2700, Winchester, Virginia 22604, or accessing the website, *www.valleyfc.com*. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Valley Farm Credit, ACA

Consolidated Balance Sheets

(dollars in thousands)	**June 30, 2005**	**December 31, 2004**
	(unaudited)	*(audited)*
Assets		
Cash	$ 323	$ 381
Loans	174,048	171,768
Less: allowance for loan losses	828	828
Net loans	173,220	170,940
Accrued interest receivable	1,388	879
Investment in other Farm Credit institutions	2,061	2,061
Premises and equipment, net	4,651	3,908
Other assets	3,027	4,088
Total assets	$ 184,670	$ 182,257
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 159,663	$ 157,765
Accrued interest payable	602	546
Patronage refund payable	7	229
Other liabilities	2,519	2,520
Total liabilities	162,791	161,060
Commitments and contingencies		
Members' Equity		
Capital stock and participation certificates	3,903	3,924
Retained earnings		
Allocated	3,784	4,388
Unallocated	14,192	12,885
Total members' equity	21,879	21,197
Total liabilities and members' equity	$ 184,670	$ 182,257

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

Valley Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

(dollars in thousands)	For the three months ended June 30, 2005	For the three months ended June 30, 2004	For the six months ended June 30, 2005	For the six months ended June 30, 2004
Interest Income				
Loans	$ 2,748	$ 2,301	$ 5,403	$ 4,550
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	1,766	1,444	3,459	2,839
Net interest income	982	857	1,944	1,711
Provision for (reversal of) loan losses	—	—	—	—
Net interest income after provision for (reversal of) loan losses	982	857	1,944	1,711
Noninterest Income				
Loan fees	104	56	154	119
Fees for financially related services	30	5	48	25
Equity in earnings of other Farm Credit institutions	293	267	583	522
Gains (losses) on sale of rural home loans	264	230	526	400
Gain on sale of assets	507	—	507	5
Other noninterest income	24	19	63	52
Total noninterest income	1,222	577	1,881	1,123
Noninterest Expense				
Salaries and employee benefits	781	691	1,634	1,497
Occupancy and equipment	138	139	268	256
Insurance Fund premium	15	36	31	72
Other operating expenses	321	228	663	447
Total noninterest expense	1,255	1,094	2,596	2,272
Income before income taxes	949	340	1,229	562
Provision (benefit) for income taxes	—	—	—	—
Net income	$ 949	$ 340	$ 1,229	$ 562

The accompanying notes are an intergral part of these financial statements.

Valley Farm Credit, ACA

Consolidated Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2003	$ 3,872	$ 4,360	$ 10,066	$ (1,322)	$ 16,976
Net income			562		562
Capital stock/participation certificates issued	146				146
Capital stock/participation certificates retired	(151)				(151)
Retained earnings retired		(561)			(561)
Distribution adjustment		103	(63)		40
Balance at June 30, 2004	$ 3,867	$ 3,902	$ 10,565	$ (1,322)	$ 17,012
Balance at December 31, 2004	$ 3,924	$ 4,388	$ 12,885	$ –	$ 21,197
Net income			1,229		1,229
Capital stock/participation certificates issued	162				162
Capital stock/participation certificates retired	(183)				(183)
Retained earnings retired		(550)			(550)
Distribution adjustment		(54)	78		24
Balance at June 30, 2005	$ 3,903	$ 3,784	$ 14,192	$ –	$ 21,879

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)
(unaudited)

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Valley Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2004, are contained in the 2004 Annual Report to Shareholders. These unaudited second quarter 2005 consolidated financial statements should be read in conjunction with the 2004 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the six months ended June 30, 2005, are not necessarily indicative of the results to be expected for the year ending December 31, 2005.

Certain amounts in prior period consolidated financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2005, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

Balance at 12-31-03	$ 2,826
(Reversal of) provision for loan losses	–
Recoveries, net of loans charged off	1
Balance at 6-30-04	$ 2,827
Balance at 12-31-04	$ 828
(Reversal of) provision for loan losses	–
Recoveries, net of loans charged off	–
Balance at 6-30-05	$ 828

As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of $2,000 in the fourth quarter of 2004 that resulted in a decrease in the allowance for loan losses.

NOTE 3 – EMPLOYEE BENEFIT PLANS

The Association participates in a Districtwide defined benefit retirement plan. The 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. The Association also participates in Districtwide Thrift and other postretirement benefit plans.

The following is a table of retirement and postretirement benefit expense for the six months ended June 30, 2005:

	For the six months ended June 30,	
	2005	**2004**
Pension	$ 199	$ 234
Thrift/deferred compensation	66	59
Other postretirement benefits	88	94
Total	$ 353	$ 387

As of June 30, 2005, no contributions have been made to the pension plan for 2005. Actuarial projections as of the last plan measurement date (September 30, 2004) did not anticipate any contributions for 2005; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.